SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 170

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

TWIN BELL OIL SYNDICATE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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APPEARANCES:

For Petitioner:

CLAUDE I. PARKER, Esq.
JOHN B. MILLIKEN, Esq.
GEORGE H. KOSTER, Esq.,

For Respondent:

J. L. BACKSTROM, Esq.,
ARTHUR CARNDUFF, Esq.

Docket No. 45052.

TWIN BELL OIL SYNDICATE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

1929 DOCKET ENTRIES:

July 1—Petition received and filed. Taxpayer notified. (Fee paid)

July 2—Copy of petition served on General Counsel.

Aug. 13—Answer filed by General Counsel.

Aug. 14—Copy of answer served on taxpayer—Circuit calendar.

1930

Jan. 16—Notice of appearance of John B. Milliken as counsel for taxpayer filed.

Sept. 2—Hearing set Oct. 20, 1930—Los Angeles, Calif.

Oct. 20—Hearing had before Miss Matthews on merits. Submitted. Balance sheet as of Jan. 1, 1925 to be submitted. Stipulations of fact filed; exhibits attached. Briefs due

2/2/31. Both parties reply briefs due Feb. 17, 1931.

Dec. 9—Transcript of hearing of Oct. 20, 1930 filed.

1931

Feb. 2—Motion for extension to Feb. 12, 1931 to file brief and 15 days thereafter to file reply brief filed by General Counsel. 2/3/31 granted to Feb. 12, 1931.

Feb. 2—Brief filed by taxpayer. 2/10/31 copy served on General Counsel.

Feb. 9—Brief filed by General Counsel.

Feb. 26—Motion for extension to March 10, 1931 to file reply brief filed by taxpayer—granted.

Mar. 4—Reply brief filed by taxpayer.

Mar. 13—Statement supplementing brief and reply brief filed by taxpayer.

Mar. 19—Further supplementary statement filed by taxpayer.

1932

May 25—Findings of fact and opinion rendered—Annabel Matthews, Division 13. Judgment will be entered under Rule 50.

July 9—Notice of settlement filed by General Counsel.

July 13—Hearing set Aug. 3, 1932 on settlement.

July 21—Motion for continuance of hearing filed by taxpayer. 7/25/32 granted to Aug. 31, 1932.

Aug. 29—Contest to settlement filed by taxpayer.

Sept. 3—Decision entered—Division 14, Logan Morris. [1*]

*Page numbering appearing at the foot of page of original certified Transcript of Record.

1932
Nov. 29—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by General Counsel.

Dec. 2—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Dec. 2—Proof of service filed by taxpayer.

Dec. 12—Proof of service filed by General Counsel.

1933
Jan. 24—Motion for extension to Mar. 29, 1933 to settle statement and transmit record filed by General Counsel.

Jan. 24—Motion for extension of 60 days to transmit record filed by taxpayer.

Jan. 24—Order enlarging time to March 29, 1933 for preparation of evidence and delivery of record entered (General Counsel).

Jan. 24—Order enlarging time to April 1, 1933 for preparation of evidence and delivery of record entered (taxpayer).

Mar. 9—Motion for extension to May 31, 1933 to settle evidence and transmit record filed by General Counsel.

Mar. 9—Order enlarging time to May 31, 1933 for preparation of evidence and transmission of record entered.

Mar. 20—Motion for extension of 60 days to transmit record filed by taxpayer.

Mar. 20—Order enlarging time to June 1, 1933 for preparation of evidence and delivery of record entered.

1933

May 15—Praecipe with proof of service thereon filed by General Counsel.

May 15—Agreed statement of evidence approved and ordered filed (General Counsel).

May 16—Praecipe with proof of service thereon filed by taxpayer.

May 16—Agreed statement of evidence lodged by taxpayer.

May 18—Agreed statement of evidence approved and ordered filed (taxpayer).

May 31—Order enlarging time to July 1, 1933 to transmit and deliver record entered (Commissioner).

May 31—Order enlarging time to July 1, 1933 to transmit and deliver record entered (taxpayer). [2]

United States Board of Tax Appeals

Docket No. 45052

TWIN BELL OIL SYNDICATE,
516 C. C. Chapman Building,
Los Angeles, California,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named taxpayer hereby appeals for a redetermination of the deficiency set forth by the

Commissioner of Internal Revenue in his deficiency letter (IT:AR:A-A NMP-60D) dated May 3, 1929, and as a basis of its appeal sets forth the following:

1. The taxpayer is a syndicate, now determined by the Commissioner of Internal Revenue to be an association, and was organized under the laws of the State of California, with principal office at 516 C. C. Chapman Building, Los Angeles, California.

2. The deficiency letter (copy of which is attached) was mailed to the taxpayer on May 3, 1929 and states a deficiency of $68,451.77.

3. The taxes in controversy are income taxes for the calendar years 1925, 1926 and 1927 and are more than $10,000.00, to-wit: $68,451.77.

4. The determination of tax contained in the said deficiency letter is based upon the following errors:

(a) That for the years 1925 to 1927 inclusive, the Commissioner erred in classifying this taxpayer's organization as an [3] association, taxable as a corporation.

(b) That for the years 1925 to 1927 inclusive, the Commissioner erred in not allowing a sufficient amount of depletion.

(c) That for the years 1925 to 1927 inclusive, the Commissioner erred in not allowing a sufficient amount of depreciation.

5. The facts upon which taxpayer relies as the basis of its appeal are as follows:

(a) That the petitioner, the Twin Bell Oil Syndicate, was organized under authority of a duly executed Declaration of Trust and that said petitioner has at all times operated under authority of said Declaration of Trust.

(b) That the trustees named in said Declaration of Trust, duly appointed and acting thereunder, had complete, entire and exclusive control over the management and operation of the said Twin Bell Oil Syndicate.

(c) That the activities of the Twin Bell Oil Syndicate are limited to the operations of but one oil property, the collection of the income therefrom, and the distribution of such income to the beneficiaries.

(d) That the said Twin Bell Oil Syndicate was not engaged in business but was engaged merely in developing the trust property, collecting income therefrom, paying the taxes and otherwise incidentally caring for the trust property and paying the net proceeds collected to the beneficiaries of said Twin Bell Oil Syndicate.

(e) That on February 11, 1922, the Twin Bell Oil Syndicate acquired an oil and gas lease on certain property located in the heart of the Santa Fe Springs oil field. [4]

(f) That the Twin Bell Oil Syndicate pays one-sixth of all oil produced and saved "as rental or royalty for the use of said land". This syndicate also pays an overriding royalty of one-twelfth of all petroleum, oil, gas and other oil products produced and saved.

(g) Royalties paid by a lessee are ordinary and necessary expenses and are proper deductions in arriving at net income.

(h) Petitioner is entitled to receive, and does constructively receive 100% of the production from

the property described in said lease and the total receipts from oil, gas and gasoline sales constitute gross income.

(i) That the gross income from the property during the taxable years 1925, 1926 and 1927 was as set out below:

1925	$959,119.20
1926	$859,518.15
1927	$425,678.04

(j) For the years 1925, 1926 and 1927 petitioner had invested in oil wells the total amount of $392,-124.21, the investment being principally made in the years 1922 and 1923. Petitioner's wells were drilled by contract. Petitioner's investment of $392,124.21 is an investment in physical property, namely, oil wells, and is subject to depreciation.

6. The petitioner prays for relief from the deficiency asserted by the respondent on the following and each of the following particulars:

A. That it be determined for the years 1925 to 1927 inclusive, that the said petitioner, the Twin Bell Oil Syndicate, is taxable as a trust and not as an association. [5]

B. That the said petitioner is entitled to an allowance for depletion for the years 1925 to 1927 inclusive at the rate of 27½% of gross income, said gross income to be determined before deducting royalties paid.

C. That the said petitioner is entitled to an allowance for depreciation for the years 1925 to 1927 inclusive computed on the basis of its total investment in oil wells, namely, $392,124.21; said depre-

ciation to be computed upon the production decline curve method, thus prorating the investment in oil wells over the useful life of the asset.

WHEREFORE, petitioner prays that this Board may hear and redetermine the deficiency herein alleged.

Respectfully,
CLAUDE I. PARKER
Counsel for Petitioner.

FRANK G. BUTTS
Washington Representative,
910 Investment Building,
Washington, D. C.
Dated: June 25th, 1929.

State of California
County of Los Angeles—ss.

Thomas H. Lipps, being duly sworn, says that he is the Secretary and Trustee of the Twin Bell Oil Syndicate above named, and as such is duly authorized to verify the foregoing petition; that he has read the said petition or had the same read to him and is familiar [6] with the statements therein contained, and that the facts therein stated are true except such facts as are stated to be upon information and belief, and these facts he believes to be true.

THOS. H. LIPPS

Subscribed and sworn to before me this 25th day of June, 1929.

[Seal] MARGUERITE LaSAGE
Notary Public in and for the County of Los Angeles, State of California. [7]

TREASURY DEPARTMENT
WASHINGTON

Office of
Commissioner of Internal Revenue

Address reply to
Commissioner of Internal Revenue

And refer to
IT:AR:A-5 May 3, 1929
NMP-60D
Twin Bell Oil Syndicate,
516 C. C. Chapman Building,
Los Angeles, California.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926, you are advised that the determination of your tax liability for the years 1925, 1926 and 1927 discloses a deficiency of $68,451.77, as shown in the statement attached.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the inclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement form will expedite the closing of your return by permitting an early assessment of any deficiencies and preventing the accum-

ulation of interest charges, since the interest period terminates thirty days after filing the agreement form, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiencies.

Respectfully,
D. H. BLAIR,
Commissioner.
By (Signed) C. B. ALLEN
Deputy Commisssioner.

Inclosures:
Statement
Form 866
Form 882

[8]

STATEMENT

IT:AR:A-5
NMP-60D

In re: Twin Bell Oil Syndicate,
516 C. C. Chapman Building,
Los Angeles, California.
Tax Liability

Year	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1925	$ 54,287.68	None	$ 54,287.68
1926	55,772.65	$ 45,369.36	10,403.29
1927	17,242.27	13,481.47	3,760.80
Totals	$127,302.60	$ 58,850.83	$ 68,451.77

1925

Net income reported on return		$266,886.27
Add:		
1. Excessive depletion	$60,521.51	
2. Excessive depreciation	90,189.73	150,711.24
Net income as adjusted		$417,597.51

Explanation of Changes

1. Depletion as adjusted in the revenue agent's report has been approved by this office. (Article 221, Regulations 69).

2. Depreciation as adjusted in revenue agent's report has been approved by this office. (Article 201, Regulations 69).

Computation of Tax

Net income as adjusted, taxable at 13%	$417,597.51
Income tax at 13%	$ 54,287.68
Tax previously assessed	None
Deficiency in tax	$ 54,287.68

The difference between the deficiency in tax shown above and that shown in the revenue agent's report results from the correction of an error in computation in computing the tax at 13% on Page 2 of report. [9]

Twin Bell Oil Syndicate. Statement.

1926

Net income reported on return		$336,069.37
Add:		
1. Excessive depletion	$59,091.93	
2. Excessive depreciation	17,969.42	77,061.35
Net income as adjusted		$413,130.72

Explanation of Changes

1. See Explanation (1) for 1925 above.
2. See Explanation (2) for 1925 above.

Computation of Tax

Net income as adjusted taxable at 13½%	$413,130.72
Income tax at 13½%	$ 55,772.65
Tax previously assessed	45,369.36
Deficiency in tax	$ 10,403.29

1927

Net income reported on return		$ 99,862.73
Add:		
1. Excessive depletion	$10,943.17	
2. Excessive depreciation	16,914.60	27,857.77
Net income as adjusted		$127,720.50

Explanation of Changes

1. See Explanation (1) for 1925 above.
2. See Explanation (2) for 1925 above.

Computation of Tax

Net income as adjusted taxable at 13½%	$127,720.50
Income tax at 13½%	$ 17,242.27
Tax previously assessed	13,481.47
Deficiency in tax	$ 3,760.80

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

amm-1

[Endorsed]: United States Board of Tax Appeals. Filed July 1, 1929. [10]

[Title of Court and Cause.]

ANSWER.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph 1 of the petition.

(2) Admits the allegations contained in paragraph 2 of the petition.

(3) Admits the allegations contained in paragraph 3 of the petition.

(4) Denies the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a), (b) and (c) of paragraph 4 of the petition.

(5) Denies the material allegations of fact contained in subparagraphs (a) to (j), inclusive, of paragraph 5 of the petition.

Denies generally and specifically each and every

allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied.

(Signed) C. M. CHAREST,
General Counsel.
Bureau of Internal Revenue.

Of Counsel:
MAXWELL E. McDOWELL,
FRANK B. SCHLOSSER,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: United States Board of Tax Appeals. Filed Aug. 13, 1929. [11]

A true copy. Teste.
(Seal) B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

[Title of Court and Cause.]

FINDINGS OF FACT AND OPINION.

Docket No. 45052. Promulgated May 25, 1932.

as a corporation for the years 1925, 1926 and 1927.

2. The reasonable allowance for depletion authorized as a deduction under the 1926 Act, in the case of oil and gas wells, is required to be equitably apportioned between lessor and lessee in case of leases. Basis for determining such reasonable allowance, prescribed in section 204 (c) (2), is 27½ per cent of gross income from the property and such reason-

able allowance so determined required to be apportioned equitably between lessor and lessee.

3. Total cost of oil wells drilled under contract represents cost of improvement subject to depreciation allowance.

John B. Milliken, Esq., George H. Koster, Esq., and Claude I. Parker, Esq., for the petitioner.

J. L. Backstrom, Esq., and Arthur Carnduff, Esq., for the respondent.

This proceeding is for the redetermination of deficiencies in income tax of the petitioner, as follows:

1925	$54,287.68
1926	10,403.29
1927	3,760.80
Total	$68,451.77

The errors assigned for all years are that the Commissioner (1) has classified petitioner as an association taxable as a corporation; (2) has not allowed a sufficient amount of depletion, and (3) has not allowed a sufficient amount of depreciation. The first error assigned was also raised by this petitioner as to the years 1922 and 1923 in Docket Number 29518, [12] decided this day, which proceeding was heard with this case. By agreement of the parties, the stipulations in each docket number filed at the hearing and the evidence introduced were to be considered as applicable to each case insofar as they are pertinent to the issues involved.

FINDINGS OF FACT.

The original declaration of trust creating the petitioner, which was executed on February 11, 1922 and

amended on April 25, 1922, was further amended on March 14, 1925. The provisions of the trust as amended on April 25, 1922, and the method of operating under the trust are set forth in our Findings of Fact in Docket Number 29815, decided this day, and are incorporated herein by reference.

The amendment of March 14, 1925 made the following changes: The minimum number of trustees was made 3, and the maximum 5. Such salaries or compensation to the officers or trustees as might be agreed upon by unanimous consent of all the trustees, were authorized. Paragraph Twelve was amended by substituting "may" for "shall", so that the first sentence thereof reads: "The trustees may call meetings of the unitholders annually * * * ". A paragraph designated Seventeenth-A, was added, which allowed the trustees to amend the trust by any resolution, minute or motion passed by unanimous vote of all the trustees, without further formality, "the intent of this paragraph being to permit the Trustees by unanimous vote to make such changes from time to time in the Declaration of Trust and the various Amended Declarations of Trust as the conditions of the trust estate may be to them deemed advisable without the necessity of executing any additional instruments or documents." Paragraph Eighteenth was so amended as to permit [13] in effect the purchase of additional property and sales by the trustees, but such acts could be done only by unanimous consent of all of the trustees at a meeting called for that purpose.

The two wells drilled on petitioner's property in

1922 were drilled under contracts with the Keck Drilling Corporation for a fixed sum. Costs of labor and materials were not segregated. The two wells drilled in 1922 were deepened in 1923, also under contracts. The total well costs of petitioner under the contracts were as follows:

				Cumulative Total
Cost to December 31, 1922,				$256,632.00
Additions during		1923—	$135,290.88	391,922.88
"	"	1924	—	391,922.08
"	"	1925	—	391,922.88
"	"	1926	—	391,922.88
Decrease	"	1927	3,543.78	388,379.10

The amounts paid to the contractors under the contracts were charged on petitioner's books as "Well Cost, No. 1 Well", and "Well Cost, No. 2 Well". The amounts paid to the contractors for drilling the wells includes the total cost of the wells and nowhere on petitioner's books was any segregation made for the portion of the cost which represented materials going into the wells and the portion which represented labor and fuel incident to the drilling.

The respondent, in the determination of the deficiencies here in question, allocated 40 per cent of the total cost of the wells to tangible equipment cost and allowed depreciation on the same. He determined that 60 per cent of the cost of the wells represented intangible drilling costs, such as labor, wages, fuel, etc., and added such 60 per cent of the well [14] costs to the lease account returnable to

the petitioner through depletion. Respondent denied the petitioner the right to charge or be allowed depreciation deductions with respect to 60 per cent of the well costs.

The parties have stipulated and agreed that if the Board should determine that the petitioner is not entitled to depreciation on the total well cost, then the determination of the respondent is correct. But if the Board should determine that the petitioner is entitled to charge the total well cost to its well account and be allowed depreciation on the same, it is stipulated that petitioner is entitled to an additional depreciation deduction for the several years as follows:

1925	$11,172.04
1926	8,953.04
1927	8,364.40

The 1/6 royalty paid to Batson and the 1/12 royalty paid to Andrews, during the taxable years, were as follows:

Year	Batson Royalties	Andrews Royalties
1925	$159,853.20	$79,926.60
1926	143,253.02	71,626.51
1927	70,946.34	35,473.17

The parties stipulated and agreed as follows:

> * * * The respondent has for purposes of computing the 27½% depletion allowance to which petitioner is entitled, reduced petitioner's gross income for each of the years 1925, 1926, and 1927 by the respective amounts of

the above mentioned royalties. Should the Board determine that petitioner's gross income should be reduced by the sums aforesaid in computing its depletion allowance then the amount of depletion allowed by the respondent is correct. Should the Board determine that petitioner's gross income should not be reduced by said royalties in computing its depletion allowance, then said sums shall be added to the petitioner's gross income as determined by the respondent, for the purpose of de- [15] termining the depletion allowance of 27½%.

The petitioner has never acquired any property other than the lease assigned to it by Lipps, and has never sold any part of such lease. The petitioner had a contract under which it sold all the oil produced to the Associated Oil Company and was under contract with the Norwalk Gas Company to sell it all the gas produced, some being produced. The petitioner entered on its books the payments received from the purchase of its oil in an "Oil Runs Account", and charged against such account the royalties to Batson and Andrews.

In 1925 and thereafter the trustees voted themselves salaries.

In 1926 some of the funds of the petitioner were used to purchase Julian Petroleum Stock which was sold in the same year at a profit. The return for 1925 was filed on Form 1041, a Fiduciary Trust Form, and the returns for 1926 and 1927 were filed on Form 1120, Corporation Income Tax Return. On

the corporation returns, the kind of business is stated to be "Oil Producers."

OPINION.

MATTHEWS: 1. The first question is whether in 1925, 1926 and 1927 the petitioner must be regarded as a trust or as an association. For the years here involved petitioner may not avail itself of section 704(a) of the Revenue Act of 1928 as it did in the proceeding for the prior years 1922 and 1923, Docket No. 29518, and the tests to be applied in distinguishing a trust from an association must be those which this Board and the courts have found applicable in 1925 and subsequent years. [16]

The Commissioner amended Article 1504 in his Regulations 65 (Revenue Act of 1924), distinguishing a trust from an association in accordance with the test laid down in the Supreme Court's decision in Hecht v. Malley, 265 U. S. 144. The explanation of this volte-face is given in G. C. M. 6517, C. B. VIII-1, 152, at 153, 154 (June 24, 1929).

The Hecht case has been so fully discussed in our prior decisions that it is unnecessary to consider it in detail here. As we pointed out in our decision in the Morris Realty Trust, 23 B. T. A. 1076, the Supreme Court put aside, apparently, the "control" test and substituted therefor business purpose, business operations and quasi-corporate structure.

A business enterprise, such as the petitioner's, created to drill for oil, and carrying on such operations, falls within the category of associations. The petitioner's organization was accomplished by Lipps

and his co-trustees with a definite business purpose in mind, and the drilling of oil wells by the petitioner on its leased land although by contract was clearly a business operation. In the taxable years the petitioner was under the exclusive control of the trustees, but that is beside the point. It did not have in some respects a quasi-corporate form. The trust declaration had been amended again on March 14, 1925, and the annual meeting of the unitholders was left to the trustees to call at their discretion, by the substitution of "may" for "shall" in paragraph Twelfth. Paragraph Eighteenth prohibited the trustees, except by their unanimous consent, from acquiring new property or selling the old. But the unitholders held transferable certificates which might be transferred like corporation stock. Under Paragraph Fifth the trustees and unitholders disclaimed any liability [17] beyond the trust corpus. Petitioner was empowered to act under a common seal. The trustees assumed the style of "officers" although Lipps testified their duties remained undifferentiated. The trustees received salaries during the years here involved. Aside from the exclusive control resident in the trustees, petitioner's organization resembles in purpose and in form that of a corporation.

The instant case is very similar to that of Little Four Oil & Gas Co. v. Lewellyn, 29 Fed. (2d) 137, affd. in 35 Fed. (2d) 149, certiorari denied, 280 U. S. 613, in which the court held the taxpayer an association taxable as a corporation, saying, "The real test is whether the stockholders or trustees, or

both combined, carry on business for profit, * * *." White v. Hornblower, 27 Fed. (2d) 777.

Petitioner relies strongly upon Extension Oil Co., 16 B. T. A. 1028, (aff'd. by C. C. A. Fifth Circuit, 47 Fed. (2d) 65), in which we held a body under facts somewhat similar to those of the instant case a trust and not an association. But that case can be easily distinguished. There the organizers combined for the sole and restricted purpose of drilling a single oil well for test purposes, and as soon as the value of the leased land was thus learned, of selling the lease. This purpose was promptly carried through in eleven months' time. Here the original trust agreement ran for twenty years and as amended for fifty; and the trustees were given full powers to develop the lease as they saw fit. They did, it is true, distribute the profits when made, but this fact of distribution does not, in our opinion, negative the petitioner's obvious business purpose. It was carrying on a business enterprise and fearful, as one of its trustees [18] confessed, all the time of being treated for Federal tax purposes as an association. This fact accounts for the excessive circumspection apparent in the amendment of its trust declaration on March 14, 1925.

Quasi-corporate form is not an indispensable element of an "association". Sears, Roebuck Co., etc. Fund v. Commissioner, 45 Fed. (2d) 506. But business purpose and activities are criteria which clearly bring the petitioner within the category of associations. Lloyd M. Willis, et al., Trustees, v. Commissioner, C. C. A. 9th, decided on May 2, 1932,

affirming 22 B. T. A. 564. Cf. Tyson, Trustee, 25 B. T. A. 520.

We are of the opinion that petitioner was an association in 1925, 1926 and 1927 and taxable, therefore, as a corporation.

2. The authority for a deduction by a corporation for depletion in the case of oil and gas wells for the taxable years, is contained in section 234(a)(8) of the Revenue Act of 1926, which reads as follows:

> Sec. 234(a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * * * *
>
> (8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;
>
> * * * * * * *

The above provision is mandatory in two respects; first, that there shall be allowed as a deduction a reasonable allowance for depletion, and, second, that such deduction shall, in the case of leases, be equi-

tably apportioned between the lessor and the lessee. [19]

The basis for determining depletion under the 1926 Acts is prescribed in section 204(c), paragraph 2, which reads as follows:

> Sec. 204(c). The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that--
>
> * * * * * * *
>
> (2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

The basis of a depletion allowance, computed without reference to the above paragraph, would be cost or March 1, 1913 value. Sec. 204(a) and (b).

Reading the two sections together, that is, the one authorizing a deduction for depletion and the other prescribing the basis, it is clear that the reasonable allowance for depletion in the case of oil and gas wells on leased property, which is to be equitably

apportioned between the lessor and the lessee, is 27½ per centum of the gross income from the property during the taxable year. If the portion of such allowance which is equitably apportioned to the taxpayer (lessor or lessee) is more than 50 per centum of the net income of such taxpayer, it is required to be reduced to an amount not in excess of 50 per centum of such net income, and if the amount apportioned to the taxpayer (the lessor or lessee) is less than it would be if computed without reference to pararaph 2, the allowance is to be based on the cost or the March 1, 1913 value.

The petitioner, as lessee, had a ¾ interest in the oil produced [20] from the wells, the other ¼ interest being in Batson, the lessor, and Andrews, the original lessee. The depletion allowance with respect to the oil and gas wells is 27½ per centum of the gross income from the wells, equitably apportioned between petitioner, Batson, and Andrews.

The depletion allowance determined by the Commissioner is 27½ per centum of the petitioner's share of the gross income from the oil and gas wells, which amount is exactly the same as would have been determined if the Commissioner had taken 27½ per centum of the total gross income from the property and apportioned ¾ of such amount to the petitioner. The amount determined by the Commissioner is not in excess of 50 per centum of the net income of the taxpayer and is not less than the deduction would be if computed without reference to the provision in section 204(c)(2). The determination of the Commissioner, as to the amount of

depletion allowable, is therefore approved.

3. The third issue is whether the petitioner should be allowed to take deductions for depreciation upon the total cost of its wells, or whether the respondent is correct in determining that 60 per cent of the well costs should be charged to the capital account, returnable through allowances for depletion. The amount of additional deductions for depreciation to be allowed, if petitioner is correct, is stipulated. Section 234(a)(8), Revenue Act of 1926, already quoted, provides in the case of mines, oil and gas wells, for "a reasonable allowance for depletion and for depreciation of improvements." [21]

Respondent relies on Article 223, Regulations 69, which provides that incidental expenses such as wages, fuel for engines, repairs, and hauling may be charged to capital account, returnable through depletion while the expense of physical property (such as derricks, machines, etc.) may be subject to depreciation.

It is admitted that petitioner drilled its wells on what is known in the trade as a "turnkey contract," that is, for a lump sum payable to the contractor, and that the petitioner, therefore, had no interest or concern with the apportionment of the costs of drilling, simply charging the whole to the well cost account. The question is whether the total cost of the wells represents an investment in an improvement which is subject to depreciation.

Since the hearing in the instant case, the same question was presented and decided in A. T. Jergins Trust, 22 B. T. A. 551. The same argument was there urged by the Commissioner but we said with

respect to amounts expended for wages, fuel, repairs, and hauling in connection with development and drilling, that "amounts expended in development and drilling operations convey to us the impression of expenditures for improvement of the property upon which the statute permits the taxpayer to deduct depreciation."

On this issue, therefore, we hold that the petitioner is entitled to the additional depreciation allowable for 1925, 1926 and 1927, in the sums stipulated.

Judgment will be entered under Rule 50. [22]

United States Board of Tax Appeals
Washington

Docket No. 45052

TWIN BELL OIL SYNDICATE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to findings of fact and opinion promulgated May 25, 1932, the respondent herein, on July 9, 1932 having filed a proposed redetermination for the years 1925, 1926 and 1927, and the petitioner on August 29, 1932, having filed notice of acquiescence to the said proposed redetermination, it is

ORDERED AND DECIDED that there are deficiencies for the years 1925, 1926 and 1927 in the amounts of $52,835.31, $9,194.63 and $2,631.60, respectively.

[Seal of Board of Tax Appeals.]

LOGAN MORRIS,
Member.

[Endorsed]: United States Board of Tax Appeals. Entered Sept. 3, 1932. [23]

[Title of Court and Cause.]

PETITION FOR REVIEW TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes TWIN BELL OIL SYNDICATE, Petitioner on Review, by its attorneys, Claude I. Parker, John B. Milliken and George H. Koster, and respectfully shows:

I.

The petitioner on review (hereinafter referred to as petitioner) is a syndicate organized under the laws of the State of California, with its principal office in the City of Los Angeles, State of California. The respondent on review (hereinafter referred to as the Commissioner) is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of

the laws of the United States. The income tax returns of the petitioner for the years 1925, 1926 and 1927, being the taxable years involved herein, were filed with the United States Collector of Internal [24] Revenue for the Sixth District of California, the office of said Collector being located within the Judicial Circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

II.

(a) Petitioner was organized as a trust under a duly executed Declaration of Trust, the trustees of which have at all times had complete, entire and exclusive control over the management and operation of the trust property. Petitioner was organized for the purpose of developing one piece of oil property held by petitioner under an oil lease and was not empowered to acquire other properties or engage in the general business of oil production. The operations of petitioner have been limited to the development of its one piece of oil property and to the sale of the oil and gas produced therefrom. Petitioner contends that it is a trust and is taxable as a trust. The Commissioner has determined and contends that petitioner is, and was at all times during the years here in controversy, an association taxable as a corporation.

(b) Under the terms of the said oil lease under which petitioner holds its property, petitioner pays and has paid, as rental or royalty for the use of said property, one-sixth and one-twelfth, or a total of one-fourth of all the oil and gas produced and saved.

All the oil produced has been sold by the petitioner to one purchaser, and all of the gas to another under contracts held by the petitioner with the said purchasers. [25] Petitioner has received the full payment for said oil and gas and has paid one-fourth thereof as rental or royalties. Total payment received for said oil and gas was the gross income of petitioner. Petitioner computed its depletion for each of said years in controversy as 27½ per cent of the total payments received during said year. The Commissioner has determined and contends that the "gross income" to be used in computing the depletion to which petitioner is entitled is gross income less the amount paid by petitioner as rental royalties.

III.

The Commissioner determined deficiencies in income tax for the years 1925, 1926 and 1927, as follows:

1925	$54,287.68
1926	10,403.29
1927	3,760.80
Total	$68,451.77

and on May 3, 1929, in accordance with the provisions of Section 274 of the Revenue Act of 1926, the Commissioner sent to the petitioner notice of said deficiencies. The major portion of said deficiencies for all of the three years arose and resulted from the determination of the Commissioner—

1. That during all of the said years petitioner was an association taxable as a corporation.

2. That in each of said years petitioner had taken an excessive depletion on its properties.

Thereafter, petitioner filed an appeal from said notice of deficiencies to the United States Board of Tax Appeals. On [26] May 25, 1932, after hearing said appeal, the United States Board of Tax Appeals promulgated its findings of fact and opinion in said appeal, wherein it sustained the Commissioner in each of the aforesaid issues here in controversy. On September 3, 1932, the Board of Tax Appeals entered its final order of redetermination in said appeal, wherein and whereby the Board of Tax Appeals ordered and decided that there were deficiencies for the years 1925, 1926 and 1927 in the amounts of $52,835.31, $9,194.63 and $2,631.60, respectively.

IV.

Petitioner says that in the record and proceedings before the Board of Tax Appeals and in the decision and final order of redetermination rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the petitioner, and petitioner assigns the following errors and each of them which he avers occurred in said record, proceedings, decision and final order of redetermination and upon which he relies to reverse the said decision and final order of redetermination so rendered and entered by the Board of Tax Appeals, to-wit:

1. The Board of Tax Appeals erred in holding that the petitioner was an association and

taxable as a corporation in each or any of the said years in controversy.

2. The Board of Tax Appeals erred in holding that the petitioner was not a trust nor taxable as a trust in all of the years in controversy.

3. The Board of Tax Appeals erred in holding that [27] the petitioner was engaged in a business operation since such conclusion is contrary to the evidence.

4. The Board of Tax Appeals erred in holding that petitioner's organization resembles in purpose and in form that of a corporation, since such conclusion is contrary to the evidence.

5. The Board of Tax Appeals erred in holding that the amount of depletion to which petitioner was entitled was 27½ per cent of its gross income less the amount paid by petitioner as rental and royalties.

6. The Board of Tax Appeals erred in holding that petitioner was not entitled to take as depletion 27½ per cent of its total gross income.

7. The Board of Tax Appeals erred in holding that the term "gross income", as used in Section 204 (c) (1) of the Revenue Act of 1926 means gross income less any sums paid out by taxpayer as rental and royalties.

8. The Board of Tax Appeals erred in its findings of fact and conclusions of law in regard to the issues here in controversy, set forth in its opinion herein. Such findings of fact are contrary to and not supported by the evidence presented.

9. The Board of Tax Appeals erred in not redetermining the deficiencies in favor of the petitioner for the years 1925, 1926 and 1927 and against the Commissioner for [28] said years.

V.

WHEREFORE petitioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, and that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

CLAUDE I. PARKER,
JOHN B. MILLIKEN,
GEORGE H. KOSTER,
Attorneys for Petitioner on Review.
808 Bank of America Bldg.,
Los Angeles, California.

Of Counsel:
L. A. LUCE. [29]

State of California,
County of Los Angeles.—ss.

George H. Koster, being duly sworn, says that he is one of the attorneys for the petitioner on review and as such is duly authorized to verify the petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision in the above entitled case; that he has read the said peti-

tion and is familiar with the statements contained therein and that the facts therein stated are true except such facts as may be stated upon information and belief and those facts he believes to be true.

GEORGE H. KOSTER.

Subscribed and sworn to before me this 23 day of Nov., 1932.

MARGUERITE LESAGE,
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: United States Board of Tax Appeals. Filed Dec. 2, 1932. [30]

[Title of Court and Cause.]

NOTICE OF FILING OF PETITION FOR REVIEW.

To:
C. M. Charest, General Counsel,
Bureau of Internal Revenue,
Washington, D. C.
Attorney for Respondent on Review.

Please take notice that TWIN BELL OIL SYNDICATE, petitioner on review in the above entitled proceeding, did on the 2nd day of December, 1932, file with the United States Board of Tax Appeals a petition for review of the decision of said Board in the above entitled cause by the United States Circuit Court of Appeals for the Ninth Circuit, a

copy of which said petition for review is herewith served upon you.

CLAUDE I. PARKER,
JOHN B. MILLIKEN,
GEORGE H. KOSTER.

Of Counsel:
L. A. LUCE.

Service of the foregoing notice and service of a copy of the petition for review mentioned in said notice is acknowledged this 2nd day of December, 1932.

C. M. CHAREST, R. I. W.
Attorney for Respondent on Review.

[Endorsed]: United States Board of Tax Appeals. Filed Dec. 2, 1932. [31]

[Title of Court and Cause.]

STATEMENT OF EVIDENCE.

The following is a statement of evidence and other proceedings in the above entitled case.

This cause came on for hearing before the Honorable Annabel Matthews, Member of the United States Board of Tax Appeals, on October 20, 1930, at Los Angeles, California, Claude I. Parker, Esq., John B. Milliken, Esq., and George H. Koster, Esq., appearing for the petitioner on review, and James L. Backstrom, Esq., and Arthur Carnduff, Esq., for Clarence M. Charest, Esq., General Counsel, Bureau

of Internal Revenue, appearing for respondent on review.

Prior to the testimony two stipulations of fact with exhibits attached thereto were submitted to and received by the Honorable Member of the Board as part of the evidence herein. It was agreed at the hearing that the stipulation in Docket No. 29518 with reference to the years 1922 and 1923 should be taken as evidence in Docket No. 40502 in so far as relevant, to avoid duplication of exhibits. Copies of these stipulations with the exhibits which are pertinent [32] to the issues here in controversy, are attached hereto, and by this reference made a part of this statement of evidence. Said stipulations contained statements of facts not in dispute.

WITNESS THOMAS H. LIPPS.

Thomas H. Lipps was called as a witness for and on behalf of the petitioner and after being duly sworn, testified as follows:

My name is Thomas H. Lipps. I reside at 722 North Rodeo Drive, Beverly Hills, Los Angeles County. I have lived in the immediate vicinity of Los Angeles for eleven or twelve years and was residing in this vicinity throughout the entire year of 1922.

Q. Can you give us a brief history of the occasion for the organization of the Twin Bell Oil Syndicate; what prompted its organization, if anything?

(Testimony of Thomas H. Lipps.)

A. Well, I had purchased a lease from Mr. Frank Andrews and his partner, Mr. Ed. Hearst; the lease had a stipulation requiring that drilling be commenced within three months after its acquisition; I had paid five thousand dollars for the lease, and in addition thereto had given Mr. Andrews and Mr. Hearst an over-riding royalty of eight and one third per cent. I did not have sufficient capital with which to commence or continue development operations as required by the lease, so I sought outside capital. I first interested five or six people in Santa Fe Springs who agreed to pay their respective pro-rata shares of the purchase price of the lease and to assist me in the raising of capital with which to drill; they did not comply with that provision, and when I found that they could not raise any capital I appealed to two other individuals to assist me, and upon making a tentative agreement with them that they would, I then went to the five or six individuals in Santa Fe Springs, explained the situation to them, and they agreed to the return of their money and to resign from the tentative syndicate that had then been organized. I then returned to my new principals, Messrs. Greer and Allen and told them I had this lease in Santa Fe Springs; [33] that I considered it one of the best in Santa Fe Springs, and that I had to have immediate capital with which to commence operations. I submitted a declaration of trust that I had prepared in connection with the prior raising of capital and Mr. Greer stated that he

(Testimony of Thomas H. Lipps.)

wanted to have the instrument examined by his attorneys before he would proceed further. Mr. Allen, associated with him, took the same attitude. They then presented that original declaration of trust to their attorney, Mr. H. L. Carnahan, and after a conference with him they insisted upon an amendment to the declaration of trust so as to make it a straight fiduciary estate rather than a corporation. I then prepared an amended declaration of trust which in turn was submitted to Mr. Greer and Mr. Allen and to Mr. Carnahan, and after revamping the instrument and changing it in various phases it was finally found acceptable to Mr. Greer and Mr. Allen, and was amended and placed of record.

Q. Was the declaration of trust to which you have just referred the declaration of trust bearing date of the 11th day of February, 1922?

A. That is the first declaration of trust.

I have been connected with the Twin Bell Oil Syndicate from the first day that I organized it. We have no directors but I have been from the date of its inception, and still am, a trustee and secretary of the syndicate. I do not recall the exact description of the properties owned by the syndicate but they consist of seven lots on Telegraph Road within about a block and a half of Four Corners. The lease covering the seven lots was acquired by me in 1922 and has constituted the property of the syndicate from that date to this. The syndicate has acquired no additional properties, and has not dis-

(Testimony of Thomas H. Lipps.)

posed of any of its property. The syndicate has operated on the lease of the property just referred to, which lease it obtained by assignment from me, and that is the only property (or lease) [34] the syndicate has ever owned.

I prepared the amendments of April 25, 1922 and March 14, 1925 to the original declaration of trust in this case, which was executed on the 11th day of February, 1922. The occasion for amending the declaration of trust of April 25, 1922, was that we wanted to have this a trust estate, we wanted to avoid the duties of directors and avoid any of the responsibility incident to the duties of a director of a corporation. We went to Mr. Carnahan for that purpose. He examined the instrument that we had and stated that if we wanted to comply with the Massachusetts Fiduciary Trust, we would have to amend our declaration of trust in such manner as would practically deprive the unit holders of all power. One of the vital features of the amendment was to change the provisions which required a two-thirds vote of all the unit holders to amend or alter the declaration of trust in any way, so that it could be altered or amended without the consent of any one but the trustees. Every unit or certificate that was ever sold or issued had stamped upon it that it was issued subject to an agreement and declaration of trust dated February 11, 1922, and the amended declaration of trust dated April 25, 1922. No units were sold prior to the amendment of the declaration of trust.

(Testimony of Thomas H. Lipps.)

The unit holders of the Twin Bell Syndicate have never had a meeting. The books of the syndicate have been kept under the direction and supervision of the trustees. The contracts of the syndicate were always made by the trustees. They also directed the carrying on of any business or expansion of operations of the [35] syndicate. The functions and duties which the trustees performed were not subjected in any wise during any of the years to the supervision on the part of the unit holders. Never to my knowledge have the unit holders at any time during the organization of this syndicate sought to control or influence in any way the activities of the trustees. The trustees controlled the policy of the syndicate with respect to the declaration of dividends. That policy has been to ascertain the amount on hand, create a reasonable reserve and distribute the balance remaining among the unit holders. There is no definite policy with regard to the declaration of dividends; the trustees have decided upon that from time to time. These decisions as to amount, time of declaration and payment of dividends have been made by the trustees. No unit holder has at any time within my knowledge sought to attack the judgment exercised by the trustees in this respect. At the time the Twin Bell Oil Syndicate was organized and began its operations, express representations were made to the prospective purchasers of the units that it would be a trust estate, that the trustees were limited in their functions, that they would not acquire any other properties, could

(Testimony of Thomas H. Lipps.)

not dispose of the present property and that the trustees would be held strictly accountable for their efforts or work, the same as a bank or any other fiduciary trust holders. The trustees negotiated the contracts for the drilling of wells on the property of the syndicate and they did not require the prior consent of the unit holders before they executed such contracts. To my knowledge no contract [36] which the Twin Bell Syndicate has ever executed has been submitted to the unit holders for their approval prior to its execution. The business of the trust consists of simply getting the profits from the oil produced on the property described in the trust estate and, after paying the charges in connection with the production of the oil and gas, distributing the remainder, less a reserve, among the unit holders.

Cross Examination.

Twin Bell Syndicate, during these years, had an office in the Chapman Building in Los Angeles. They always had a bookkeeper in the office and sometimes had help to assist. Also I have been in the office. We have the same officers now that we had when we were first organized. Mr. Allen was elected amongst the trustees as president, Mr. Greer was vice president and treasurer, and I was secretary. These officers have never been changed. They did not exercise the duties of officers in carrying out the duties of the syndicate, they exercised the duties of trustees. All minutes were kept as trustees and all notices and letters were sent out under

(Testimony of Thomas H. Lipps.)

the name of the trustees. Occasionally we have to sign a contract where an official title is required and we use it. I believe the returns are signed by the officers. Those officers were elected by the trustees themselves; they simply appoint one another. The president did not have any particular duties, any more than the treasurer had. The secretary was the only one who had any particular duties which were to run the executive department of the business; that is, see that the bills were paid and so [37] forth. The president examined the reports made by the superintendent and held meetings from time to time. I do not recall any official duties that he performed as president. Nothing has ever been done unless there was a meeting first held by the trustees and the minutes passed on the books as trustees. I was one of the trustees and kept track of the minutes and sent out notices of dividends, saw that they were not spending more money than we had in the Treasury, and executed such papers as it was necessary to execute.

When this property was acquired it was undeveloped oil property. The syndicate went ahead and contracted for sales of oil, had wells drilled and found oil. The syndicate still has this property. The wells were kept in production. We appointed a superintendent and production man and told him to keep track of the production and check up with the Oil Company, and check up the returns. We sold the oil produced to the Associated Oil Company under a contract which we have always had. We

(Testimony of Thomas H. Lipps.)

did not store any oil at any time. We also produced some gas from this property. We drilled only two wells on the property and did not consider drilling other wells on that property until the deep zone was found. A man by the name of Oglesby, who has been with us for years, looked after the production of the oil in these wells. Ordinarily, we had three or four men working at the wells but it sometimes varied if we had to redrill or redeepen, at which times we would have more. There was considerable work at various times to keep the wells in proper production and that was always [38] looked after by the syndicate. The production of gas also required attention. It was sold to the Norwalk Gas Company under a contract which was renewed from time to time. I do not recall the length of the period over which the contract extended but the same Company is still taking the gas. The principal reason for entering into a contract with the Norwalk Gas Company was for them to furnish the boiler and give us return gas in order that we might produce properly.

Mr. Greer took personal charge of the outside work but nothing was ever done without the consent of the trustees. I do not mean to say that if he changed a beam or something like that he took it up with the trustees, but the purchasing of a boiler or machinery or anything requiring an expenditure of over a few hundred dollars was generally taken up at a meeting of the trustees. The ordinary affairs that came up daily were taken care of

(Testimony of Thomas H. Lipps.)

by the manager and with one of the trustees. As a matter of fact there were not any particular duties delegated to any one trustee. If something was needed out in the field, they would telephone in. Mr. Greer would get in touch with me or Mr. Allen and we would have a consultation and give them their orders. The officers were not paid any salary until after the unit holders had received a complete return of all their money and a substantial profit. I think we did not vote any salary to ourselves until 1924 or 1925. After that the trustees received salaries under a resolution which states that they are receiving salaries as trustees. The trustees always receive the same salary regardless [39] of what they were called upon to do.

We never sold any property of the syndicate. We never had any meetings of the unit holders. If the declaration of trust provides that the trustees "shall" call a meeting of the unit holders, it was an oversight and an error. I believe it should have read "may". I believe it was corrected subsequently.

Because of the fact that we could not assess our own unit holders, we organized a second syndicate and permitted all unit holders of the first syndicate to invest additional money to drill to newly discovered deeper zones, and in consideration of this second Twin Bell Syndicate drilling to the deeper zones, we gave them one-half of the proceeds received from those deeper zones. That was on the property of the syndicate but the unit holders of the Second Twin Bell Syndicate were practically

(Testimony of Thomas H. Lipps.)

the same unit holders as the First Twin Bell Syndicate. All the unit holders of the First Syndicate did not join in the Second Syndicate and a few outsiders did join in the second syndicate. My recollection is that there were about 15 per cent of outsiders.

Certificates were issued to each unit holder, as provided in the amended declaration of trust. At no time during the years here involved did the trustees ever consult with the unit holders in connection with this property. We made the transactions with the Twin Bell No. 2 without consulting the unit holders. We simply wrote them a letter and told them we were organizing another syndicate and that we were giving the first unit holders preference. We held open for a period of twenty days, giving them a right to come [40] in on the basis of actual cost—ten dollars—and the public were allowed to come in at a higher price—twenty dollars. The benefit of that, of course, was received by all of the unit holders. The unit holders had nothing to say as to whether or not we should make this offer. We made it without consulting them. These matters were handled in accordance with the agreements which have been introduced in evidence here and they carried out the purpose stated in those agreements and were handled in the way in which the agreements provide.

Redirect Examination.

The Twin Bell Syndicate No. 2 that has been referred to was an absolutely independent and sepa-

(Testimony of Thomas H. Lipps.)

rate syndicate trust from the Twin Bell Oil Syndicate, petitioner here.

The persons designated as the president, secretary and treasurer of the Twin Bell Oil Syndicate were also trustees, and if the president, secretary or treasurer were to perform certain duties or certain acts, as president or secretary, it was always first taken up with the trustees to receive their prior consent.

The Twin Bell Oil Syndicate had only two wells. It did not drill these wells itself but employed independent contractors and the wells were dug pursuant to a contract. The contracts were made by the trustees with the independent contractors and the well was turned over to the syndicate as a completed project for so much money. Those contracts have been introduced in evidence. [41]

We found it necessary to organize the Twin Bell Oil Syndicate No. 2, the separate and independent syndicate to which I have referred, because we had no way of drilling an oil well to a deeper and newly discovered zone unless we could assess the unit holders and as we could not assess the unit holders and had to have money from some source, we decided upon organizing a second syndicate and permitting those that wanted to put up additional money to put their money in that. The declaration of trust provides that there shall be no assessments levied against any unit holder. We had no money with which to deepen the wells because we distributed all of the money we had on hand to the unit holders with the exception of the reserve for

(Testimony of Thomas H. Lipps.)

taxes. It was our plan to distribute the money to the unit holders as soon as it was received and we did that.

Recross Examination.

I do not know, but I presume that the item in the 1925 return of the syndicate "interest earned—$7,185.69" refers to the money paid by the Savings Bank on account of the money deposited there. I do not recall for what the item of rent—$1,260.00 on that return was for. I would have to examine the books. It may have been for rental of equipment.

After examining the return for 1926, I recall the transaction shown in Item No. 8 as profits from the sale of real estate, stocks and bonds and other capital assets—$26,590.00. I think we loaned the Julian Petroleum Corporation some $75,000.00 and [42] received a return of one per cent a month on it and put the money into the syndicate. As I recall it, the transaction shown in the return whereby we acquired stock of the Julian Petroleum Company for $48,375.00 and sold it for $74,965.00, was a personal transaction between Mr. Greer and Mr. Allen, to which I did not assent, but in view of the fact that they figured that the syndicate had a right to do it, I told them that if they would guarantee it personally and put the profit that they might obtain from it into the syndicate, I would permit it to go on as a syndicate transaction, but it was not authorized by the syndicate itself,—by the unanimous consent of the trustees. I felt as long as there was a profit made the unit holders should get it. They bought the stock with the syndicate money but it was an

(Testimony of Thomas H. Lipps.)

unauthorized act and they had no right to take it out. I took the profits as a trustee. In 1926 we had a cash balance on hand in the beginning of $55,000.00, and at the end of the year of $164,000.00, but this was not a sufficient amount to drill a well after we had been notified that the Government might construe us as an association and that we should create a reserve with which to pay the taxes. If it had not been for the unauthorized amount of income taken up we would not have had any cash balance. The syndicate kept the profit from the unauthorized transaction because I did not feel that any of the trustees had a right to profit on any transaction in which the syndicate was involved. The money went to the unit holders, not the trustees. I insisted that the unit holders get it. The trustees had a good many transactions with the Julian Petroleum Company. I do not know [43] how the syndicate became involved; I know the syndicate funds were withdrawn and I went on record as being opposed to the transaction. Later, when I found it proved to be a success, I said, "We want the profit of it because it was syndicate funds", which I thought was proper to do. During these years all the trustees lived in Los Angeles and they remained here at all times during those years.

Redirect Examination.

The officers which the syndicate had during these years were not required to hold stock in the syndicate. A person could be an officer without being a unit holder and he could be a trustee without being a unit holder.

(Testimony of Thomas H. Lipps.)

Recross Examination.

There was a time when I was not a unit holder. The other officers were lucky, they held practically all their units and I sold mine. I have been an officer since the inception of the Company, and there have been times when I was not a unit holder; I do not recall at what times, but it was not for very long. I would have to go back to the books to find out if it was during these years. I sold out and came back in again.

WITNESS G. B. MORRIS

G. B. Morris called as a witness on behalf of the petitioner, after being duly sworn, testified as follows:

My name is G. B. Morris. I reside at 557 North Mariposa Avenue. I am employed by the Twin Bell Oil Syndicate as auditor and as such I have general supervision and control of the books [44] of account and record and have had such control since 1922 when the syndicate was organized.

I heard the testimony of Mr. Lipps that the oil was sold in a pipe line to the Associated Oil Company. On our books and records of account, we took up the total payments which we received from the Associated Oil Company which represented the total oil that came from the property and went through their pipe line. We charged against that

(Testimony of G. B. Morris.)

account, called the "Oil Runs Account", the royalties payable to the royalty holders and charged it against the account of the Associated Oil Company. For example, if during the year there were 1000 barrels of oil that went through that pipe line from this property our contract was that the Associated was to pay $1.00 a barrel, we would have taken up on our books $1,000 and then deducted from that $250.00 or 25 per cent of that to which the royalty holders were entitled.

It was stipulated by the parties in the stipulation hereto attached, that petitioner paid as royalty or rent during the years in controversy, the following sums, to-wit:—

1925	$239,779.80
1926	$214,879.53
1927	$106,419.51

(Said sums were one-fourth of the gross income of petitioner for the respective years.)

It was further stipulated that "The respondent has for purposes of computing the 27½ per cent depletion allowance to which petitioner is entitled, reduced petitioner's gross income for each [45] of the years 1925, 1926 and 1927 by the respective amounts of the above mentioned royalties".

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by C. M. Charest, General Counsel, Bureau of Internal Reve-

(Testimony of G. B. Morris.)

nue, as attorney for the Commissioner of Internal Revenue.

C. M. CHAREST
General Counsel
Bureau of Internal Revenue

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned as attorney for the petitioner on review.

GEORGE H. KOSTER
Attorney for Petitioner on Review

The foregoing evidence is all of the material evidence adduced at the hearing, and in order that the same may be preserved and made a part of this record, this statement of evidence is duly approved and settled this 18th day of May, A. D. 1933.

(S) ANNABEL MATTHEWS
Member
United States Board of Tax Appeals

[Endorsed]: United States Board of Tax Appeals. Lodged May 16, 1933.

[Endorsed]: United States Board of Tax Appeals. Filed May 18, 1933. [46]

[Title of Court and Cause.]

STIPULATION

It is hereby stipulated and agreed by and between counsel for respective parties that Exhibits A-1, A-2,

and A-3 attached hereto and made a part hereof were executed on the dates indicated on said exhibits and constitute the original declaration of trust together with all amendments thereto under and by reason of which the petitioner operated during the years 1922, 1923, 1925, 1926, and 1927.

Attached hereto are the returns filed by petitioner for the years 1922, 1923, 1925, 1926, and 1927.

For the years 1922 and 1923 the petitioner filed a return on Form 1041, this being a fiduciary form of return, and said return for 1922 was filed with the Collector of Internal Revenue at Los Angeles on May 15, 1923 and the return for 1923 was filed by petitioner on Form 1041, this being a fiduciary form of return, and was filed with the Collector of Internal Revenue at Los Angeles on March 14, 1924.

It is stipulated and agreed that the rulings of the Commissioner referred to in Section 704 (a) of the Revenue Act of 1928, are such rulings as are referred to or found as a fact by the United States Board of Tax Appeals in its decisions reported in E. A. Landreth 15 BTA 655, Wilkins and Lange 15 BTA 1183, Woodrow Lee Trust 17 BTA 109, and Van Cleave Trust 18 BTA 486.

It is stipulated and agreed that should the Board find petitioner is taxable as an association rather than as a Trust for the years 1922 and 1923, then petitioner is entitled to depletion for the year 1922 in the sum of $249,899.28 and depreciation on wells for the year 1922 in the sum of $82,358.44 and depletion for the year 1923 in the sum of $494,153.40 and to depreciation for the year 1923 in the sum of $37,-

677.75, in lieu of any and all amounts for depletion allowed in 60-day letter.

CLAUDE I. PARKER
GEORGE H. KOSTER
JOHN B. MILLIKEN
Attorney for Petitioner.
JAMES L. BACKSTROM
ARTHUR CARNDUFF
Attorney for Respondent. [47]

JOINT EX. A-1

COPY

DECLARATION OF TRUST

KNOW ALL MEN BY THESE PRESENTS:

That the Trust Estate created herein shall be designated by the name and shall be known as

TWIN BELL OIL SYNDICATE

and that

WHEREAS, Thomas H. Lipps, of the County of Los Angeles, State of California, has heretofore sold, assigned, transferred and conveyed unto Elwood De Garmo, Henry J. Grohs, James E. Mayberry, Thos. H. Lipps, Gilbert S. Sheets, L. E. H. DeSallier and Frank Martin, hereinafter designed as Trustees, oil and gas leases on that parcel and piece of real property more particularly described as follows:

Lots 2, 3, 4, 5, 6, 7 and 8, in Block 85 in the town of Santa Fe Springs, County of Los Angeles, State of California, as per map recorded in Book 26, Page 37, et seq., Miscellaneous Records of Los Angeles County;

IT IS HEREBY EXPRESSLY UNDERSTOOD AND AGREED, that the said trustees have accepted, received and will hold, such rights, titles, interests and estates as have been assigned and conveyed to them and by them acquired under the above mentioned assignment and conveyance, in trust, nevertheless, for the uses and purposes set forth in this Declaration of Trust, to-wit:

TRUST CREATED:

FIRST: The said trustees, or their successors, shall hold all the funds and property of said trust estate now or hereafter coming into their possession, for the purposes, with the powers, and subject to the limitations herein declared; and it is hereby expressly declared that a trust and not a partnership or corporation is hereby created; and that the TWIN BELL OIL SYNDICATE is a trust and not a partnership or a corporation.

The principal place of business and office of said trust [48] estate, and of the trustees, shall be in the City of Los Angeles, State of California.

TRUST ESTATE AND PROPERTY:

SECOND: It is an express condition of this trust that the trust estate and property are, and shall be, only such rights, titles, estates and interests as said trustees may have received under said assignment and conveyance or shall hereafter acquire subject to this trust, and the trustees are not, and shall not be responsible or assume any liability for the nature, value or extent of the title to any of the property hereinbefore described and accepted in trust here-

under, or that may hereafter be added to this trust as hereinbefore provided, nor for any adverse or conflicting claims or interests therein of any persons.

DUTIES OF TRUSTEES:

THIRD: During the term of this trust, said trustees, out of the moneys subject to this trust, whether principal or income therefrom, shall drill or cause to be drilled on the above described premises, a well, or wells, for oil to a depth of four thousand feet unless oil in paying quantity be found at a lesser depth; and pay, or cause to be paid from such moneys, the entire expense of drilling and equipping said well, or wells, including all rigging, casing, pipe and other material and all labor, fuel and water, and assume all responsibility and liability incident to said operation, subject to the limitations herein set forth. And when oil shall be found in paying quantity in the said well, or wells, such well, or wells, will be completed and shut in with all necessary fittings and equipment and connected with pipe lines for marketing of oil therefrom; and from such moneys, subject to this trust, said trustees shall erect necessary derricks, buildings and other structures and procure necessary machinery and procure reasonable insurance upon all insurable property owned by them on the trust estate and shall pay or secure the payment of all liens, encumbrances, taxes, assessments [49] or other charges against said property, properly chargeable to the trustees and necessary to protect their title to the trust estate, for the purpose of this trust; but in the event that said trustees shall not have such funds available and of sufficient amount

to fully pay for such charges and expenses, or any operations required of them herein, either said trustees nor any unit holder shall be liable in any event, amount or degree, or to any person for any loss or damage suffered by reason thereof, to the trust estate or to any unit holder of this trust or to any other person whomsoever.

POWER OF TRUSTEES:

FOURTH: The Trustees, in the name of the Twin Bell Oil Syndicate, shall have full power, except as herein limited, to develop, operate, sell and deal in petroleum, oil properties and wells, and to buy, acquire, construct, maintain, operate pipe lines, and deal in machinery, implements, tools, conveniences of all kinds capable of being used in connection with oil, gas or other utilities. The execution of all contracts, of all conveyances and transfers and of all other instruments relative to the trust fund or any part thereof, by or pursuant to the authorization of a majority of the said trustees, or their successors, shall always be sufficient.

The trustees hereunder and their successors, shall have and exercise the exclusive management and control of the trust estate; they may adopt and use a common seal, collect, sue for, receive and receipt for all sums of money at any time coming due to said trust; may employ counsel to begin procedure, defend or settle suits at law, in equity or otherwise, and to compromise or refer to arbitration, any claims in favor of or against the Trust.

During the term of this Trust and to enable them to properly execute the same according to the terms,

provisions and intentions hereof, the trustees shall have full power to hold or convey, grant, bargain, sell, lease for terms, to repair and make any [50] improvements thereon or therein of such character, amount, costs and from such funds or property, subject to this trust as they may deem advisable; and to drill, operate for, develop and remove petroleum, oil, naphtha, natural gas, asphaltum or other kind substances in and from the real property described hereinabove, or any other property which may be acquired by said Trustees; and generally in all respects to manage, handle, develop and dispose of the whole or any part of the trust estate in conformity with the terms of this trust, said trustees are hereby vested with the sole power and discretion to discern what will constitute principal and what will constitute gross income therefrom and net income available for the payment or distribution under the terms of this trust.

LIABILITY OF TRUSTEES AND UNITHOLDERS:

FIFTH: The trustees shall have no power to bind the unit holders personally, otherwise than as hereinbefore provided and the unitholders and their assigns and all persons and corporations extending credit or contracting with or having claim against the trustees shall look only to the funds or property of the trust for payment under such contract or claim, or for payment of any debt, damage, judgment or decree, or of any money that may otherwise become due or payable from them to the trustees, so that neither the trustees nor the unit holders, present

or future, shall be personally liable therefor, and neither the trustees, nor any of them, shall ever be personally liable hereunder as partners, or otherwise; but for all debts the trustees shall be liable only to the extent of the trust funds or property held by them. In every written order, contract or obligation which the trustees shall give or enter into, it shall be the duty of the trustees to stipulate that neither the trustees nor the unit holders or their successors shall be held to any personal liability under or by reason of any order, contract, or obligation. [51]

The trustees shall not be liable for errors of judgment, either in holding the property originally conveyed to them or in acquiring and afterward holding additional property, nor for any loss arising out of any investment, nor for any act performed or omitted by them in the execution of this trust in good faith, nor shall they be liable for the acts or omissions of each other, or any officer, agent, or servant appointed or by acting for them; and they shall not be obligated to give any bond to secure the due performance of this trust by them. No assessment shall ever be made upon the unit holders or their assigns.

NUMBER OF TRUSTEES AND VACANCIES:

SIXTH: The trustees named in this agreement shall hold office until the first Tuesday of March, 1923. Commencing on the first Tuesday of March, 1923, and on each first Tuesday of March thereafter, there shall be held annual meetings of the unit holders of the syndicate, to be called upon five days written notice to each unit holder, at the offices of the

Syndicate, and at such annual meeting, in addition to such general business as may come before it, there shall be elected by a majority vote, seven trustees to hold office for a period of one year, and until their successors are elected.

Any vacancy occasioned by the death or resignation, or refusal to act of any trustee, may be filled by the remaining trustees, and the trustee, or trustees so appointed, shall hold office until his successor is duly elected at the annual meeting herein referred to, and have the same powers, duties and liabilities as the original trustees hereunder. Upon resignation, decease, incapacity or removal, or vacancy for any cause, the title of the outgoing trustee, or trustees, shall rest in the remaining trustee, and upon the filling of any vacancy by the remaining trustees, as aforesaid, the title of the whole trust property shall rest in all the trustees whether appointed hereunder or by the remaining trustees to fill vacancies, as hereinbefore provided. [52]

UNITS IN TRUST ESTATE:

SEVENTH: The trust estate consists of Three Thousand equal and undivided interests, which undivided interests are herein referred to as "Units", of the nominal or par value of $100.00 each; and the owners of the undivided interests, or units, of the trust estate, and their assigns and grantees, are herein designated as "Unitholders". The units in said trust estate are undivided and indivisible and the holders and owners of the said units have no right of partition or segregation or dissolution either in law or in equity; and the trust estate shall

be managed and controlled as an entirety and for the benefit of all the unitholders according to the number of units held by each and as set forth herein.

In consideration of the sale, transfer, assignment and conveyance by the said Thos. H. Lipps, of the lease hereinbefore referred to, to the trustees hereunder, it is mutually agreed that the said Thos. H. Lipps shall be entitled to receive therefor Fifteen Hundred (1500) units of the par value of One Hundred ($100) Dollars each, and the said trustees have and do hereby agree to issue to the said Thos. H. Lipps, or his order, transferable certificates for the said 1500 units in the said trust estate; and shall likewise pay, in the manner hereinafter provided, to-wit: after the cost of the well and drilling operations have been repaid to the unit holders, the sum of Seven Thousand Five Hundred ($7,500.00) Dollars out of the first run of oil, as an additional bonus for the transfer of the lease to the Syndicate.

SALE OF UNITS AND CERTIFICATES:

EIGHTH: In addition to the said 1500 units to be issued to the said Thos. H. Lipps, in consideration for the transfer, sale, assignment and conveyance of the leases hereinbefore referred to, the trustees shall issue and sell, at public or private sale, upon such terms and for such prices as they may deem expedient such additional units as may be necessary to provide means for [53] the prosecution and furtherance of the objects of this trust and

to defray the costs and expenses thereof, subject, however, to the approval of the Commissioner of Corporations or other proper officers of the State of California.

In the case of a loss or destruction of any certificates for units issued by the trustees, the trustees may, under such conditions as they may deem expedient, issue a new certificate or certificates in the place of one lost or destroyed.

As evidence of this ownership of said units, the trustee shall cause to be issued to each unit holder, a transferable certificate or certificates, which certificates shall be in the form following, to-wit:

Number: Units:

TWIN BELL OIL SYNDICATE

Los Angeles, California

Capital—$300,000.00

THIS IS TO CERTIFY THAT.....

is the owner of.....units fully paid and non-assessable of the par value of One Hundred ($100.00) each, of the beneficial interest in the TWIN BELL OIL SYNDICATE a business trust, transferable only on the books of the company by the owner thereof in person or by duly authorized attorney upon surrender of this certificate properly endorsed.

This certificate is held subject to an Agreement and Declaration of Trust dated February 11th, 1922, and which is recorded in the offices of the County Recorder of Los Angeles, California, and which is hereby referred to and made a part of this certificate.

Said Declaration of Trust provides:

That no unit holder shall ever be personally liable for any debt, covenants, demands, contracts, torts of any kind of this company.

WITNESS, the signatures of the trustees of said company this.....day of.....A. D. 19.....

TWIN BELL OIL SYNDICATE

By.....

President of the Board

Attest

.....

Secretary of the Board. [54]

DIVIDENDS:

NINTH: The trustees shall from time to time declare dividends out of the net earnings or profits of said trust, which said dividends shall dispose of all the net earnings or profits, less the actual minimum cost of maintenance and operation. It is understood, however, that before any dividends shall be generally divided amongst all unit holders of record, there shall first be paid out of the first run of oil, to the unit holders and investors who have purchased the fifteen hundred units from the proceeds of which the well has been drilled, the full amount of their investment, and thereafter in addition thereto, a bonus to Thos. H. Lipps in the sum of Seven Thousand Five Hundred ($7,500.00) Dollars, with interest at the rate of eight per cent per annum from February 9th, 1922, and that only after such unit holders have been repaid for said investment by them, and the said bonus to Thos. H. Lipps shall

have been paid, shall dividends be declared generally amongst all unit holders of record; the specific intent of this paragraph being to repay to investors the amount of cash which each has invested for the purpose of drilling the aforesaid well, as well as to repay the bonus provided for the said Thos. H. Lipps, before the profits shall be divided generally amongst all unitholders interested in the syndicate.

MEETINGS OF TRUSTEES AND BY-LAWS:

TENTH: Meetings of the Trustees shall be held from time to time upon the call of the president or any three of the Trustees. A majority of the trustees shall constitute a quorum, but in no event shall any meeting of said trustees be held, nor any business transacted be binding upon this trust, unless and until all of the trustees herein named shall first have received written notice of said meeting; the concurrence of all the trustees shall not be necessary to the validity of any action taken by them, but the wish of a majority of the trustees present and voting at any [55] meeting shall be conclusive unless in this declaration of trust specifically provided otherwise. The trustees may make, adopt, amend or repeal such by-laws, rules and regulations, not inconsistent with the terms of this instrument, as they may deem necessary or desirable for the conduct of their business and for the government of themselves and their agents, servants and representatives.

OFFICERS:

ELEVENTH: The trustees shall annually elect from among their number a president and vice-

president, and shall also annually elect a treasurer and secretary, and they shall have authority to appoint such other officers, agents and attorneys as they may from time to time deem necessary or expedient for the conduct of their business. They shall have authority to remove any and all officers, agents and employees at their pleasure; to accept resignations and to fill any vacancy occurring in the office of the President, Vice-President, Treasurer or Secretary, for the unexpired term, and shall likewise have authority to elect temporary officers to serve during the absence or disability of the regular officers. The president, vice-president, treasurer and secretary shall have such authority and perform such duties as may from time to time be determined by the trustees. No salaries or compensation of any kind or character shall be paid to such officers.

TWELFTH: The Trustees shall call meetings of the unitholders annually on the first Tuesday of March, and shall prepare and submit to the unitholders at such meeting, a full report of their operations, including moneys received and disbursed for the year ending on the 31st day of January preceding. They shall elect the trustees as hereinbefore provided and dispose of such general business affecting this trust as may come before them. Special meetings of the unitholders may be called at any time [56] upon giving the notice as hereinafter provided for.

NOTICE OF MEETINGS:

THIRTEENTH: Notice of annual and special meetings shall be deemed binding upon each of the

unit holders if mailed, prepaid, to the last address given by him, to the trustees, or in default thereof, to his last business place or abode. Notice of meetings shall be given five (5) days beforehand and may be given by advertisement for three (3) successive days in a paper of general circulation published in the City of Los Angeles, County of Los Angeles, State of California, the last publication to be at least five (5) days before the date of the meeting, or may be mailed, at the option of the trustees. In notices of special meetings, the purpose thereof shall be stated.

FOURTEENTH: Unitholders may vote by proxy at any annual or special meeting called by the trustees, and a majority of the unitholders present may decide all questions at such meetings, the holders of fifty per cent of the units, or their proxies, constituting a quorum.

FIFTEENTH: The trustees shall keep a book for the recording therein of the names and addresses of unitholders and of the sales and transfers of units. No sale or transfer of any unit in said trust estate shall be valid or binding on said trustees, or their successors until the purchaser or the transferee shall have notified the trustees in writing of the said purchase and shall have, also in writing, accepted, consented to, approved, ratified and confirmed all of the terms, conditions and provisions of this Declaration of Trust, except where such interest may pass or be transferred by decree, order or judgment of a court of competent jurisdiction, and then only upon proof satisfactory to the

trustees of the regularity and validity of the proceedings in such matter being presented to the trustees; and in all cases of transfer of units, the trustees may require proof satisfactory to themselves of the title of the claimant as owner of the units.

[57]

EFFECT OF DEATH OF TRUSTEES OR UNITHOLDERS:

SIXTEENTH: The death of a unit holder or trustee during the continuance of this trust shall not operate to determine the trust, nor shall it entitle the legal representatives of the deceased unitholder to an accounting or to take any action in the courts or elsewhere, against the trustees, but the executors, administrators or assigns of any deceased unitholder shall succeed to the rights of said decedent under this trust upon surrender of the certificate, or certificates for the units owned by him.

AMENDMENT OF DECLARATION:

SEVENTEENTH: The trustees may, with the consent of the holders of two-thirds of the outstanding units of the trust estate, alter or amend this declaration or terminate this trust or transfer the trust property to a person or persons, or a duly organized corporation.

DURATION OF TRUST:

EIGHTEENTH: This trust shall endure and continue until the expiration of twenty (20) years from the date hereof, and may then, or at any time prior thereto, be terminated, or may then be continuued by a two-thirds (2/3) majority of the votes of units then outstanding. The trustees shall not be

required to give bond, and each shall be liable only for his own acts and then only for wilful breach of trust. Upon termination of the trust hereby created, the trustees shall liquidate the trust estate and divide the remaining assets among the unitholders in proportion to their respective interests, or shall convey the whole of the trust estate subject to all then existing assessments, encumbrances, or other matters affecting title to the unit holders therein entitled to take the same under the terms hereof; provided, however, that first all the charges and expenses therein due the trustees hereunder shall be fully relieved and discharged from all then existing and future obligations and liabilities. [58]

NINETEENTH: None of the powers in this Agreement set out shall be construed as authorizing the trustees, without the consent of a majority of the units represented at a regularly called meeting of the unitholders, from acquiring new properties or leases, or from disposing of the whole or any part of the capital, or assets, or other properties of this trust, either in whole or in part, it being the specific intention of this paragraph to compel said trustees to secure the approval and ratification of the majority of the units represented at any regularly called meeting before disposing of the properties above listed, or acquiring new properties on behalf of the trust.

IN WITNESS WHEREOF, the parties hereto have hereunto subscribed their names at the City of Los Angeles, County of Los Angeles, State of Cali-

fornia, on this 11th day of February, 1922.

ELLWOOD DeGARMO
HENRY J. GROHS
JAMES E. MAYBERRY
THOS. H. LIPPS
GILBERT S. SHEETS
per E. L. Sheets
FRANK MARTIN
L. E. H. DeSALLIER

State of California,
County of Los Angeles.—ss.

On this 11th day of February, A. D. 1922, before me, Daniel M. Potter, a Notary Public in and for said County and State, residing therein, duly commissioned and sworn, personally appeared Ellwood DeGarmo, Henry J. Grohs, James E. Mayberry, Thos. H. Lipps, Gilbert S. Sheets, Frank Martin and L. E. H. DeSallier, known to me to be the persons whose names they subscribed to the within instrument, and acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this Certificate first above written.

[Seal] DANIEL M. POTTER,
Notary Public in and for said
County and State. [59]

JOINT EX. A-2

COPY

AMENDED DECLARATION OF TRUST
OF
TWIN BELL OIL SYNDICATE

KNOW ALL MEN BY THESE PRESENTS:

That the Declaration of Trust dated on or about the 11th day of February, 1922, and duly recorded in the office of the County Recorder of Los Angeles County on the 20th day of March, 1922, in Book 984, page 270, official records of Los Angeles County, California, is, in accordance with the powers vested in the Board of Trustees by paragraph 17, hereby amended to read as follows:

That the Trust Estate created herein shall be designated by the name and shall be known as

TWIN BELL OIL SYNDICATE

and that

WHEREAS Thomas H. Lipps, of the County of Los Angeles, State of California, has heretofore sold, assigned, transferred and conveyed or is about to convey unto Ellwood DeGarmo, Henry J. Grohs, James E. Mayberry, Thos. H. Lipps, Gilbert S. Sheets, L. E. H. DeSallier and Frank Martin, hereinafter designated as Trustees, and to the trustees succeeding them in interest for the purpose of this trust, oil and gas leases on that parcel and piece of real property more particularly described as follows:

Lots 2, 3, 4, 5, 6, 7 and 8, in Block 85, in the town of Santa Fe Springs, County of Los Angeles, State of California, as per map recorded

in Book 26, page 37, et seq., Miscellaneous Records of Los Angeles County;

IT IS HEREBY UNDERSTOOD AND AGREED, that the said trustees have accepted, received and will hold, such rights, title, interests and estates as have been assigned and conveyed to them and by them acquired under the above mentioned assignment and conveyance, in trust, nevertheless, for the uses and purposes set forth in this Declaration of Trust, to-wit:

TRUST CREATED: [60]

FIRST: The said trustees, or their successors, shall hold all the funds and property of said trust estate now or hereafter coming into their possession, for the purposes, with the powers, and subject to the limitations herein declared; and it is hereby expressly declared that a trust and not a partnership or corporation is hereby created; and that the TWIN BELL OIL SYNDICATE is a trust and not a partnership or corporation.

The Principal place of business and office of said trust estate, and of the trustees, shall be in the City of Los Angeles, State of California.

TRUST ESTATE AND PROPERTY:

SECOND: It is an express condition of this trust that the trust estate and property are, and shall be, only such rights, titles, estates and interests as said trustees may have received under said assignment and conveyance, or shall hereafter acquire subject to this trust, and the trustees are not, and shall not be responsible or assume any liability for

the nature, value or extent of the title to any of the property hereinbefore described and accepted in trust hereunder, nor for any adverse or conflicting claims or interests therein of any persons.

DUTIES OF TRUSTEES:

THIRD: During the term of this trust, said trustees, out of the moneys subject to this trust, whether principal or income therefrom, shall drill or cause to be drilled on the above described premises, a well, or wells, for oil to a depth of four thousand feet unless oil in paying quantity be found at a lesser depth; and pay, or cause to be paid from such moneys, the entire expense of drilling and equipping said well or wells, including all rigging, casing, pipe and other material and all labor, fuel and water, and assume all responsibility and liability incident to said operation, subject to the limitations herein set forth. And when oil shall be found in paying quantity in the said well, or wells, such well, or [61] wells, will be completed and shut in with all necessary fittings and equipment and connected with pipe lines for marketing of oil therefrom; and from such moneys, subject to this trust, said trustees shall erect necessary derricks, buildings and other structures and produce necessary machinery and procure reasonable insurance upon all insurable property owned by them on the trust estate and shall pay or secure the payment of all liens, encumbrances, taxes assessments or other charges against said property, properly chargeable to the trustees and necessary to protect their title to the trust estate, for the purpose of this trust; but

in the event that said trustees shall not have such funds available and of sufficient amount to fully pay for such charges and expenses, or any operations required of them herein, neither said trustees nor any unit holder shall be liable in any event, amount or degree, or to any person for any loss or damage suffered by reason thereof, to the trust estate or to any unit holder of this trust or to any other person whomsoever.

POWERS OF TRUSTEES:

FOURTH: The trustees, in the name of the TWIN BELL OIL SYNDICATE, shall have full power, except as herein limited, to develop, operate, sell and deal in petroleum, oil properties and wells, and to buy, acquire, construct, maintain, operate pipe lines and deal in machinery, implements, tools, conveniences of all kinds capable of being used in connection with oil, gas or other utilities. The execution of all contracts, of all conveyances and transfers and of all other instruments relative to the trust fund or any part thereof, by or pursuant to the authorization of a majority of the said trustees, or their successors, shall always be sufficient.

The trustees hereunder and their successors, shall have and exercise the exclusive management and control of the trust estate; they may adopt and use a common seal, collect, sue for, receive and [62] receipt for all sums of money at any time coming due to said trust; may employ counsel to begin procedure, defend or settle suits at law, in equity, or otherwise, and to compromise or refer to arbitration, any claim in favor of or against the Trust.

During the term of this Trust and to enable them to properly execute the same according to the terms, provisions and intentions hereof, the trustees shall have full power to hold or convey, grant, bargain, sell, lease for terms, to repair and make any improvements thereon or therein of such character, amount, costs and from such funds or property, subject to this trust as they may deem advisable; and to drill, operate for, develop and remove petroleum, oil naphtha, natural gas, asphaltum or other kind substances in and from the real property described hereinabove; and generally in all respects to manage, handle, develop and dispose of the whole or any part of the trust estate in conformity with the terms of this trust.

LIABILITY OF TRUSTEES AND UNIT-HOLDERS:

FIFTH: The trustees shall have no power to bind the unit holders personally, otherwise than as hereinbefore provided and the unitholders and their assigns and all persons and corporations extending credit or contracting with or having a claim against the trustees shall look only to the funds or property of the trust for payment under such contract or claim, or for payment of any debt, damage, judgment or decree, or of any money that may otherwise become due or payable from them to the trustees, so that neither the trustees nor the unit holders, present or future, shall be personally liable therefor, and neither the trustees nor any of them shall ever be personally liable hereunder as partners, or otherwise; but for all debts the trustees shall be liable

only to the extent of the trust funds or property held by them. In every written order, contract or obligation which the trustees shall give or enter into, it shall be the duty of the trustees to stipulate that [63] neither the trustees nor the unitholders or their successors shall be held to any personal liability under or by reason of any order, contract or obligation.

The trustees shall not be liable for errors of judgment, either in holding the property originally conveyed to them, nor for any act performed or omitted by them in the execution of this trust in good faith; nor shall they be liable for the acts or omissions of each other, or any officer, agent, or servant appointed by or acting for them; and they shall not be obligated to give any bond to secure the due performance of this trust by them. No assessment shall ever be made upon the unit holders or their assigns.

NUMBER OF TRUSTEES AND VACANCIES:

SIXTH: The number of trustees shall not be less than five (5) nor more than seven (7), and any vacancy occasioned by the death or resignation or refusal to act of any trustee may be filled by the remaining trustees, and have the same powers, duties and liabilities as the original trustees hereunder. Upon resignation, decease, incapacity or removal, or vacancy for any cause, the title of the outgoing trustee, or trustees, shall rest in the remaining trustees, and upon the filling of any vacancy by the remaining trustees, as aforesaid, the title of the whole trust property shall rest in all the trustees whether

appointed hereunder or by the remaining trustees to fill vacancies, as hereinbefore provided.

UNITS IN TRUST ESTATE:

SEVENTH: The trust estate consists of Three Thousand equal and undivided interests, which undivided interests are herein referred to as "Units", of the nominal or par value of One Hundred ($100.00) Dollars each; and the owners of the undivided interests, or units, of the trust estate, and their assigns and grantees are herein designated as "Unitholders." The units in said trust estate are undivided and indivisible and the holders and owners of the [64] said units have no right of partition or segregation or dissolution either in law or in equity; and the trust estate shall be managed and controlled as an entirety and for the benefit of all the unitholders according to the number of units held by each and as herein set forth.

In consideration of the sale, transfer, assignment and conveyance by the said Thos. H. Lipps, of the lease hereinbefore referred to, to the trustees hereunder, it is mutually agreed that the said Thos. H. Lipps shall be entitled to receive therefor Fifteen Hundred (1500) units of the par value of One Hundred ($100.00) Dollars each, and the said trustees have and do hereby agree to issue to the said Thos. H. Lipps, or his order, transferable certificates for the said Fifteen Hundred (1500) units in the said trust estate; and shall likewise pay, in the manner hereinafter provided, to-wit; after the cost of the well and drilling operations have been repaid to the unitholders, the sum of Seven Thousand Five Hun-

dred ($7500.00) Dollars out of the first run of oil, as an additional bonus for the transfer of the lease to the Syndicate.

SALE OF UNITS AND CERTIFICATES:

EIGHTH: In addition to the said 1500 units to be issued to the said Thos. H. Lipps, in consideration for the transfer, sale, assignment and conveyance of the leases hereinbefore referred to, the trustees shall issue and sell, at public or private sale, upon such terms and for such prices as they may deem expedient, such additional units as may be necessary to provide means for the prosecution and furtherance of the objects of this trust and to defray the costs and expense thereof, subject, however, to the approval of the Commissioner of Corporations or other proper officers of the State of California.

In the case of a loss or destruction of any certificates for units issued by the trustees, the trustees may, under such [65] conditions as they may deem expedient, issue a new certificate or certificates in the place of one lost or destroyed.

As evidence of the ownership of said units, the trustees shall cause to be issued to each unitholder, a transferable certificate or certificates, which certificates shall be in the form following, to-wit:

Number: Units:

TWIN BELL OIL SYNDICATE

Los Angeles, California

Capital — $300,000.00

This Is to Certify That.....is the Owner of .....units fully paid and non-assessable of the par

value of One Hundred ($100.00) Dollars each, of the beneficial interest in the TWIN BELL OIL SYNDICATE, a business trust, transferable only on the books of the company by the owner thereof in person or by duly authorized attorney upon surrender of this certificate properly endorsed.

This certificate is held subject to an agreement and Declaration of Trust dated February 11th, 1922, and also to an Amended Declaration of Trust executed on or about the 25th day of April, 1922, both the said Declaration of Trust and Amended Declaration of Trust thereto being duly recorded in the Office of the County Recorder of Los Angeles County and both of which are hereby referred to and made a part of this Certificate.

Said Declaration of Trust provides:

That no unitholder shall ever be personally liable for any debt, covenants, demands, contracts or torts of any kind of the company.

WITNESS the signatures of the trustees of said company this.....day of .....A. D., 19.....

TWIN BELL OIL SYNDICATE

By.....

President of the Board.

Attest:

.....

Secretary of the Board.

DIVIDENDS:

NINTH: The trustees shall declare dividends quarterly out of the net earnings or profits of trust, which said dividends shall dispose of all the net

earnings or profits less the actual maximum cost of maintenance and operation. It is understood, however, that before any dividends shall be divided generally amongst all unit- [66] holders of record, there shall first be paid out of the first run of oil, to the unitholders and investors who have purchased the fifteen hundred units from the proceeds of which the well has been drilled, the full amount of their investment, and thereafter in addition thereto, a bonus to Thos. H. Lipps in the sum of Seven Thousand Five Hundred ($7500.00) Dollars, with interest at the rate of eight per cent (8%) per annum from February 9th, 1922, and that only after such unitholders have been repaid for said investment by them, and the said bonus to Thos. H. Lipps shall have been paid, shall dividends be declared generally amongst all the unitholders of record; the specific intent of this paragraph being to repay the investors the amount of cash which each has invested for the purpose of drilling the aforesaid well, as well as to repay the bonus provided, generally amongst all unitholders interested in the Syndicate.

MEETINGS OF TRUSTEES AND BY-LAWS:

TENTH: Meetings of the trustees shall be held from time to time upon the call of the president or any three of the trustees. A majority of the Trustees shall constitute a quorum, but in no event shall any meeting of said trustees be held, nor any business transacted be binding upon this trust, unless and until all of the trustees herein named shall first have received written notice of said meeting; the concurrence of all the trustees shall not be neces-

sary to the validity of any action taken by them, but the wish of a majority of the trustees present and voting at any meeting shall be conclusive unless in this declaration of trust specifically provided otherwise. The trustees may make, adopt, amend or repeal such by-laws, rules and regulations, not inconsistent with the terms of this instrument, as they may deem necessary or desirable for the conduct of their business and for the government of themselves and their agents, servants and representatives.

OFFICERS: [67]

ELEVENTH: The trustees shall annually elect from among their number a president and vice-president, and shall also annually elect a treasurer and secretary, and they shall have authority to appoint such other officers, agents and attorneys as they may from time to time deem necessary or expedient for the conduct of their business, and upon such terms as they may deem necessary or advisable. They shall have authority to remove any and all officers, agents and employees at their pleasure; to accept resignations and to fill any vacancy occurring in the office of the President, Vice-President, Treasurer, or Secretary, for the unexpired term, and shall likewise have authority to elect temporary officers to serve during the absence or disability of the regular officers. The president, vice-president, treasurer and secretary shall have such authority and perform such duties as may from time to time be determined by the trustees, but no salaries or compensation of any kind or character shall be paid to such officers or trustees.

MEETINGS:

TWELFTH: The trustees shall call meetings of the unitholders annually on the first Tuesday of March and shall prepare and submit to unitholders at such meeting a full report of all their operations, including moneys raised and disbursed for the year ending on the 31st day of December preceding. Special meetings of the unit holders may be called by the trustees at their pleasure by giving the notice hereinafter provided for.

NOTICE OF MEETINGS:

THIRTEENTH: Notice of annual and special meetings shall be deemed binding upon each of the unitholders if mailed, prepaid, to the last address given by him, to the trustees, or in default thereof, to his last business place or abode. Notice of meetings shall be given five (5) days beforehand and may be given by advertisement for three (3) successive days in a paper of general cir- [68] culation published in the City of Los Angeles, County of Los Angeles, State of California, the last publication to be at least five (5) days before the date of the meeting, or may be mailed, at the option of the trustees. In notices of special meetings, the purpose thereof shall be stated.

VOTING:

FOURTEENTH: The trustees shall keep a book for recording therein the names and addresses of unitholders and of the sales and transfers of units. No sale or transfer of any unit in said trust estate shall be valid or binding on said trustees until same

shall be transferred on the books of the Syndicate, and in all cases of transfer of units, the trustees may require proof satisfactory to themselves of the title of the claimant as owner of the units.

EFFECT OF DEATH OF TRUSTEES OR UNITHOLDERS:

FIFTEENTH: The death of a unitholder or trustee during the continuance of this trust shall not operate to terminate the trust, nor shall it entitle the legal representatives of the deceased unitholder to an accounting or to take any action in the courts or elsewhere, against the trustees, but the executors, administrators or assigns of any deceased unitholder shall succeed to the rights of said decedent under this trust upon surrender of the certificate, or certificates, for the units owned by him.

AMENDMENT OF DECLARATION:

SIXTEENTH: The trustees may by ananimous consent alter or amend this Declaration of Trust.

SEVENTEENTH: This trust shall endure and continue until the expiration of fifty (50) years from the date hereof and may then or at any time prior thereto be terminated by ananimous consent of the trustees. But the trustees shall not be required to give bond, and each shall be liable only for his own acts and then only for wilful breach of trust. Upon termination of the trust [69] hereby created, the trustee shall liquidate the trust estate and divide the remaining assets among the unitholders in proportion to their respective interests, or shall convey the whole of the trust estate subject

to all then existing assessments, encumbrances, or other matters affecting title to the unitholders therein entitled to take the same under the terms hereof; provided, however, that first all the charges and expenses therein due the trustees hereunder shall be fully paid and said trustees shall be fully relieved and discharged from all then existing and future obligations and liabilities.

EIGHTEENTH: None of the powers in this Declaration of Trust set out shall be construed as authorizing the trustees to acquire any properties or oil leases, or to dispose of the whole or any part of the capital or assets or other properties of this trust either in whole or in part, it being the specific intention of this paragraph to limit the powers of the trustees to the management and control of the property now owned, and controlled by the Syndicate, including the proceeds to be derived from the discovery and development of oil on the premises owned or controlled by the Syndicate, and to compel the said trustees to make quarterly distribution of the entire net proceeds amongst unit holders of record as in Paragraph Ninth of this Declaration of Trust set forth.

In all other respects the aforesaid Declaration of Trust is hereby declared to remain unchanged and in full force and effect as though the Amendments and alteration hereby made had been therein originally incorporated, and

We, the Undersigned, do further certify that we do collectively constitute the entire Board of Trustees of the aforesaid Trust, that no units or

certificates of beneficial interest as in said Declaration of Trust set forth have been issued but that we, the undersigned, being all the members of the Board of Trustees as at present constituted, are collectively the sole and exclusive [70] owners of the entire trust estate and have full right, power and authority to execute this Instrument and make the Amendments herein set forth.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and affixed their seals this 25th day of April, 1922.

WALTER B. ALLEN,
P. H. GREER
L. E. H. DeSALLIER
HENRY J. GROHS
THOS. H. LIPPS

State of California,
County of Los Angeles.—ss.

On this 28th day of April A. D., 1922, before me, Daniel M. Potter, a Notary Public in and for said County and State, residing therein, duly commissioned and sworn, personally appeared Walter B. Allen, Perry H. Greer, Thos. H. Lipps, L. E. H. DeSallier and Henry J. Grohs, known to me to be the persons whose names are subscribed to the within Instrument, and acknowledged to me that they executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this

Certificate first above written.

(Signed) DANIEL M. POTTER,
Notary Public in and for said
County and State.

[Endorsed]: United States Board of Tax Appeals. Filed Oct. 20, 1930. [71]

[Title of Court and Cause.]

STIPULATION

It is hereby stipulated and agreed by and between counsel for the respective parties that all facts stipulated in Docket 29518 insofar as pertinent hereto may be used by the Board and is made a part of this stipulation.

It is stipulated and agreed that Exhibits 1, 2, and 3 are the lease together with assignments thereof which the petitioner received upon its organization and relate to and cover the property which petitioner owned and from which it derived its oil.

It is further stipulated and agreed that Exhibits 4, 5, and 6 are the permits which petitioner received from Corporation Commissioner of the State of California.

It is further stipulated and agreed that Exhibits 7, 8, 9 and 10 are the contracts which petitioner entered into with respect to the wells which were drilled upon its property.

It is further stipulated and agreed that Exhibit 11 correctly reflects the total well costs of petitioner.

The respondent in the determination of the deficiencies here in question allocated 40% of said cost price of the wells to tangible equipment costs and allowed depreciation on the same. The respondent determined that 60% of the said cost price of the wells represented intangible drilling costs such as labor, wages, fuel, etc., and has added said 60% to the Lease account returnable to petitioner through depletion and denied petitioner the right to charge or be allowed depreciation deductions with respect to said 60%.

If the Board should determine that petitioner should not be allowed depreciation on the total well costs then the determination of the respondent is correct in this regard. Should, however, the Board determine that petitioner should be permitted to charge the total well cost to its oil well account and be allowed depreciation on same, then it is stipulated that petitioner is entitled to an additional depreciation deduction for the year 1925 in the amount of $11,172.04 [72]

for the year 1926 in the amount of $8,953.04 and for the year 1927 in the amount of $8,364.40.

It is stipulated and agreed that petitioner pursuant to the lease agreements attached hereto as Exhibits 1 and 2 paid as 1/6 royalty or rent in the year 1925, the sum of $159,853.20, in the year 1926 the sum of $143,253.02, in the year 1927 the sum of $70,946.34 and as one-twelfth royalty or rent the sum of $79,926.60 in the year 1925, the sum of $71,626.51 in the year 1926 and the sum of $35,473.17 in the year 1927. The respondent has for purposes of com-

puting the 27½% depletion allowance to which petitioner is entitled, reduced petitioner's gross income for each of the years 1925, 1926, and 1927 by the respective amounts of the above mentioned royalties. Should the Board determine that petitioner's gross income should be reduced by the sums aforesaid in computing its depletion allowance then the amount of depletion allowed by the respondent is correct. Should the Board determine that petitioner's gross income should not be reduced by said royalties in computing its depletion allowance, then said sums shall be added to the petitioner's gross income as determined by the respondent, for the purpose of determining the depletion allowance of 27½%.

All exhibits hereinbefore referred to are attached hereto and hereby made a part hereof.

CLAUDE I. PARKER,
GEORGE H. KOSTER,
JOHN B. MILLIKEN,
Attorney for Petitioner.
JAMES L. BACKSTROM,
ARTHUR CARNDUFF,
Attorney for Respondent. [73]

EXHIBIT 1.

LEASE

(Also known as William O. Batson.)

THIS INDENTURE OF LEASE, made and entered into this 8th day of December, 1921, by and between W. O. BATSON, his wife, hereinafter called the Lessor (whether one or more), and F. A. ANDREWS, hereinafter called the Lessee.

WITNESSETH:

That the Lessor, for and in consideration of the sum of Ten Dollars and other valuable consideration to him in hand paid, the receipt whereof is hereby acknowledged, leases to the Lessee all those certain pieces or parcels of land situate in the County of Los Angeles, State of California, and more particularly described as follows:

Lots Two (2), Three (3), Four (4), Five (5), Six (6), Seven (7) and Eight (8), in Block Eighty-five (85), in the Town of Santa Fe Springs, as per map recorded in Book 26, Page 37, et seq., Miscellaneous Records of said County.

Subject to reservations of record.

Said lease shall be on the following terms and conditions:

1. The lease shall continue for a period of twenty (20) years from and after the date of this agreement, and as long thereafter as oil or gas may be produced thereon in paying quantities.

2. Lessee shall have the sole and exclusive right of prospecting the demised premises and drilling for and removing oil and gas therefrom and to establish and maintain on said premises such tanks, boilers, houses, engines and other apparatus and equipment, power lines, pipe lines, roads, and other appurtenances which may be necessary or convenient in the operation or production of oil or gas from said property.

Lessee shall have the right during the term of

the lease to drill for and develop such water on said premises as he may require in his operations.

3. The Lessee agrees to start the drilling of a well for oil within fifteen (15) months from the date of this agreement except as hereinafter provided, and to continue the work of drilling such well after commencing the same, with reasonable diligence, until a depth of four thousand (4000) feet has been reached, unless oil is discovered in paying quantities at a lesser depth or unless such formations are encountered at a lesser depth as will indicate to the geologist of the Lessee that further drilling would be unnecessary.

4. In the event of the discovery of oil in any well on adjacent property within seventy-five (75) feet of the boundary lines of the demised premises, and the production therefrom of oil in paying quantities for a period of thirty (30) days thereafter, the well hereinbefore agreed to be drilled shall be commenced by the Lessee to offset such producing well on the adjacent property, within ninety (90) days thereafter.

5. Lessee may at any time before discovery of oil on the demised premises quitclaim the said property or any part thereof to the Lessor, his successors or assigns, and thereupon all rights and obligations of the parties hereto one to the other shall thereupon cease and determine as to the premises quitclaimed. [74]

6. Drilling and pumping operations on said property shall be suspended only in the event that they are prevented by the elements, accidents, strikes,

lockouts, riots, delays in transportation or interference by federal or state action, or other causes beyond the reasonable control of the Lessee, or so long as oil of the quality produced on said property shall be less than Fifty Cents (50c) per barrel at the well.

7. The Lessee shall pay to said Lessor, commencing on December 30, 1921, and thereafter on the 30th day of each month, in advance, the sum of Fifty Dollars ($50.00) as rental of said property, and shall continue said payment of said monthly rental in advance until said Lessee shall have commenced the drilling of a well if within a period of six (6) months from date of this lease;

If the well is not commenced within six (6) months from date of lease, the Lessee may extend the period of commencing the well for an additional period of six (6) months by paying to the Lessor One Hundred Dollars ($100.00) per month as rental, for such period during said additional six (6) months, or such portion of such additional period of six months until the drilling of a well shall be commenced;

If well is not commenced within twelve (12) months from date of lease, the Lessee may further extend the period of commencing the well for an additional period of three (3) months, by paying to the Lessor One Hundred and Fifty Dollars ($150.00) per month for rental for such additional period until drilling operations are commenced.

8. The Lessee shall have the free use of so much of the oil water and gas produced on said

property as may be required in the operation of the property.

9. Other than the oil specified in Paragraph 8 hereof, the Lessee shall pay as rental or royalty for the use of said land one-sixth (1/6) of all oil produced and saved therefrom, said payment to be made in money or in kind at the Lessor's option. If the rental is paid in kind, the oil shall be delivered into tanks maintained on the property for that purpose, as produced, and shall be stored for a period not exceeding thirty (30) days without charge. If the royalty is paid in money, then the Lessee shall pay the Lessor on the 20th day of each and every calendar month one-sixth (1/6) of the market price at the well of all oil removed from said property during the preceding calendar month. The option of the Lessor to take the royalty in money or in kind shall only be exercised once every six (6) months, and then on thirty (30) days' notice in writing to the Lessee. If no notice be given, it shall be deemed that the royalties are payable in money.

10. If casing head gasoline is manufactured on the premises or elsewhere by the Lessee from gas produced in said well or wells, then the Lessee shall pay to the Lessor, after deducting the cost of producing and selling said gasoline, one-sixth (1/6) of the proceeds of said gasoline.

11. The Lessee shall pay all taxes on his improvements and five-sixths (5/6) of the increase of the taxes, based on assessment of 1921-22, resulting from the discovery of oil on said property and of all oil stored on said land on the first Monday

in March of each year while this lease remains in force and effect. The Lessee is hereby authorized to pay all the taxes on said land and improvements and to deduct the Lessor's share thereof from the amount of royalties which shall fall due.

12. All payments to the Lessor shall be made by paying the same into the First National Bank of Whittier, California. [75]

13. A well is paying quantities to hereby defined as follows:

A well that shall be producing oil at the rate of forty (40) barrels of forty-two (42) gallons each per day of twenty-four (24) hours, for thirty (30) consecutive days, shall be considered as producing oil in commercial paying quantities.

This definition shall not apply to wells to be operated on the expiration of the twenty year period or on the abandonment of a portion of the premises, and in such case the Lessee may operate such wells as the Lessee in his discretion shall deem sufficiently productive to operate.

14. Lessee shall carry on all operations in a careful, workmanlike manner and in accordance with the laws of the State of California, Lessee shall keep full records of the operations and production and sale of products from said property, and such records and the operation of the property shall be at all reasonable times open to the inspection of the Lessor of his representative. Whenever requested by the Lessor, the Lessee shall furnish the Lessor a copy of the logs of all wells drilled on said property.

15. The lessor shall have the right to the use of the surface of said land to such extent as will not interfere with the proper operations of the Lessee for oil. The Lessee agrees to conduct his operations so as to interfere as little as is consistent with the economical operations of the property for oil, and agrees to pay for any damage which may be done to buildings or growing crops through his negligence.

16. The Lessor may have the use of any water and gas developed on said property for his domestic purposes, as long as the same is now required by the Lessee. The transportation of such water, and gas, shall be taken at a point to be indicated by the Lessee, and carried to the point of use at the cost and sole risk of the Lessor.

17. The Lessee shall have at any time the right to remove any houses, tanks, pipe lines, structures, casing or other equipment, appurtenances and appliances of any kind, brought by him upon said land, whether affixed to the soil or not; provided, that in case of an abandonment of any well, if the Lessor shall desire to retain the same as a water well he may notify the Lessee to that effect, and thereupon said Lessee shall leave such casing in the well as the Lessor shall require and the Lessor shall pay to the Lessee fiifty per cent (50%) of the first cost of such casing in the ground.

18. In the event of any dispute as to any of the terms of this lease, or the performance of any of the conditions hereof, by the Lessee, the same shall

be submitted to arbitration. An arbitrator shall be appointed by each of the parties hereto, and a third by the two so appointed. Any decision by a majority of such arbitrators shall be binding upon both parties.

19. In the event of any breach of any of the terms or conditions of this lease by the Lessee, and the failure to remedy the same within sixty (60) days after written notice from the Lessor so to do, then at the option of the Lessor this lease shall forthwith cease and determine and all rights of the Lessee in and to the said land be at an end.

20. Any notices from the Lessor to the Lessee may be given by registered mail addressed to the Lessee at his office, Room 519, Story Building, Los Angeles, California, and the Lessee or his successors or assigns may at any time by written notice to the Lessor by registered mail change the place of giving notice, and after such written notice to the Lessor, the Lessor shall send all notices intended for the Lessee or his successors or assigns to the address which may be so indicated. [76]

21. Any notice from the Lessee to the Lessor may be given by sending the same by registered mail addressed to the Lessor at Santa Fe Springs, California, or at such other address as he may designate in writing.

22. Nothing herein shall be construed as limiting the number of wells which the Lessee may drill, should he so elect, in excess of the one well above specified.

23. All work done on the land by the Lessee shall be at Lessee's sole cost and expense, and Lessee agrees to protect said land and the Lessor from all claims of contractors, laborers, or for material, and the Lessor may post and keep posted on said land such notices as he may desire in order to protect said land against liens.

24. On the expiration of this lease, or sooner termination thereof, Lessee shall quietly and peaceably surrender possession of the premises to the Lessor, and shall, as far as possible, remove the debris from all sump holes and excavations made by him and fill the same with earth, and restore the land nearly as possible to the condition in which it was received.

25. Any sub-lease of the demised premises or any part thereof, or any assignment of this lease, shall be upon and subject to each and all of the terms, conditions and covenants herein, and the same shall be binding upon each and all of the heirs, executors, personal representatives and assigns of the parties hereto.

26. It is also agreed by and between the parties hereto that the Lessee may make such assignments of this lease, or make such sub-leases of any part or the whole of said demised premises, to any person or persons or to any corporation or corporations, either formed or to be formed, for the purpose of enjoying the benefits hereunder given, as may to him be deemed advisable.

IN WITNESS WHEREOF, the parties hereto

have executed this agreement, the day and year hereinabove first written.

W. O. BATSON,
MABEL BATSON,
F. A. ANDREWS,

State of California,
County of Los Angeles—ss.

On this 8th day of December, A. D., 1921 before me, J. H. ARDIS, a Notary Public in and for the said County and State, residing therein, duly commissioned and sworn, personally appeared W. O. Batson, Mabel Batson, his wife and F. A. Andrews, known to me to be the persons whose names are subscribed to the within instrument, and acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this Certificate first above written.

[Notarial Seal] J. H. ARDIS,
Notary Public in and for said County and State of California. [77]

EXHIBIT 2.

AGREEMENT OF ASSIGNMENT OF LEASE.

THIS INDENTURE, made and entered into this 10th day of February, 1922, at Los Angeles, in the County of Los Angeles, State of California, by and between F. A. ANDREWS and HAZEL WOLFF ANDREWS, his wife, hereinafter called parties of the first part, and THOMAS H. LIPPS, hereinafter called party of the second part,

WITNESSETH:

THAT, WHEREAS, said F. A. Andrews, one of the parties of the first part herein, has heretofore entered into an agreement of lease dated the 8th day of December, 1921, wherein and whereby William O. Batson and Mabel Batson, his wife, leased to the said F. A. Andrews for the period of Twenty (20) years and so long thereafter as oil or gas may be produced therefrom in paying quantities, Lots Two (2), Three (3), Four (4), Five (5), Six (6) Seven (7) and Eight (8) in Block Eighty-five (85) in the Town of Santa Fe Springs, County of Los Angeles, State of California, as per map recorded in Book 26, page 37 et seq., Miscellaneous Records of said Los Angeles County, subject to reservations; which Lease is recorded in Book 838, Page 140, Official Records said County.

NOW THEREFORE, in consideration of the sum of Ten Dollars ($10.00) and other valuable considerations to them in hand paid by the party of the second part herein, receipt of which is hereby acknowledged, the parties of the first part hereby sell, assign, transfer and set over to the party of the second part the aforesaid lease, copy of which is hereto attached marked Exhibit "A", and hereinafter designated the "Batson" lease, and all of the estate, right, title and interest of said parties of the first part in and to said lease and said premises thereunder demised.

And in consideration of the sum of Ten Dollars ($10.00) and other good and valuable consideration to him in hand paid by the parties of the first part,

receipt of which is hereby acknowledged, the party of the second part hereby agrees to perform each and all of the covenants and obligations of said "Batson" lease agreed to be performed by said F. A. Andrews, one of the parties of the first part hereunder, of every kind and character; and in addition to such performance of said "Batson" lease, said Thomas H. Lipps, party of the second part hereunder, agrees further:

"(1) That he will pay to the parties of the first part herein, over and in addition to the one-sixth (1/6) royalty agreed to be paid to the Lessors under said "Batson" lease, one-twelfth (1/12) of all petroleum, oil, gas and other oil products, and casing-head gasoline, produced and saved from each and all wells on said premises by the party of the second part, said royalty to be paid in lawful money of the United States, or in kind, at the option of the parties of the first part, and to be paid or delivered to said parties of the first part in the same manner and under the same privileges as is provided for the payment or delivery of the Lessors one-sixth (1/6) royalty under said "Batson" lease;

(2) That the party of the second part herein shall [78] start the drilling of a well for oil on said premises within six (6) months from the date of this assignment and at an earlier date if necessary to meet the hereinafter offset requirements of this assignment;

(3) All payments to parties of the first part

shall be made by paying them to their credit at the Bank of Italy, Pico Branch, in the City of Los Angeles, California, or such other place as may be designated in writing by said parties of the first part;

(4) That party of the second part herein, in the event of discovery of oil in any well on any adjacent property within three hundred (300) feet of the boundary line of the demised premises, or the discovery of oil by the Petroleum Midway Company in their well now drilling on the Foix premises situated about 500 feet northerly from the Batson leasehold and the production of oil therefrom in paying quantities as prescribed in the Batson lease, or the production of oil therefrom in an average of one hundred barrels per day for thirty days, shall, within sixty (60) days thereafter, commence the drilling of a well for oil to offset such producing well on adjacent property;

(5) That party of the second part will keep full, true and correct books of account of all oil, gas and other substances produced upon said premises during the life of this assignment, and that such books of account shall at all reasonable hours be open to inspection of the parties of the first part hereunder, or their duly authorized agents;

(6) That on the expiration of this assignment, or sooner termination thereof, the party of the second part shall quietly and peaceably surrender possession of the premises to the

parties of the first part and shall remove all property, equipment and appurtenances and appliances belonging to the second party therefrom;

(7) That any notices from the parties of the first part to the party of the second part may be given by registered mail addressed to the party of the second part at 511 Charles C. Chapman Bldg., Los Angeles, California, and any and all notices from the party of the second part to the parties of the first part may be given by registered mail addressed to the parties of the first part at 519 Story Building, Los Angeles, California, and the party of the second part, or his successors or assigns, or the parties of the first part, or their successors or assigns, may at any time, by written notice, one to the other, by registered mail, change the place of giving notice, and after such written notice of such change shall send all notices to the address which may be so indicated.

(8) That if the party of the second part hereunder shall fail to perform any of the covenants or conditions as herein provided, or shall fail to perform any of the terms, covenants or conditions required to be performed by the said F. A. Andrews by and under the [79] original "Batson" lease, the parties of the first part hereunder shall have the right to terminate all rights of the party of the second part hereunder on account of such failure to perform any of said conditions, upon giving

to said party of the second part notice in writing of such failure to comply, and if the said party of the second part has not fully and completely complied with the same within thirty (30) days after written notice from the parties of the first part so to do, then this lease shall forthwith cease and determine without further notice, and all rights of the party of the second part in and to the said land and said lease shall be at an end, and said parties of the first part may re-enter said premises, and a quitclaim deed shall be immediately furnished by the party of the second part to said parties of the first part of all his rights in and to said premises and said "Batson" lease and this assignment.

Parties of the first part agree:

(1) That they will reimburse party of the second part herein for one-twelfth (1/12) of all of the taxes paid by party of the second part on the increase of taxes based on the assessment of 1921-1922 resulting from the discovery of oil on said property, and for taxes on all oil belonging to parties of the first part stored on said land on the first Monday of March of each year while the said "Batson" lease remains in force and effect, and the party of the second part is hereby authorized to deduct same from the amount of royalty which shall fall due to parties of the first part;

(2) That party of the second part may at

any time before discovery of oil on the demised premises quitclaim the said premises, or any part thereof, to the parties of the first part, their successors or assigns, and thereupon all right and obligation of the parties hereto, one to the other, shall thereupon cease and determine as to the premises quitclaimed.

(3) That party of the second part shall have at any time the right to remove any houses, tanks, pipe lines, structures, casing or other equipment, appurtenances and appliances of any kind, brought by him upon said land, whether affixed to the soil or not, under the conditions provided in said "Batson" lease, provided said party of the second part has not defaulted in the performance of any of the terms or conditions of the said "Batson" lease or of this assignment.

The parties hereto mutually agree:

(1) That, in the event of any dispute as to any of the terms of this assignment, or the performance of any of the conditions hereof, the same shall be submitted to arbitration. One arbitrator shall be appointed by the parties of the first part and one by the party of the second part hereto, and a third by the two so appointed. Any decision by a majority of such arbitrators shall be binding upon the parties; [80]

(2) That the party of the second part may make such assignment of this assignment, or

may make such subleases of any part or the whole of said demised premises, to any person or persons or to any corporation or corporations, either formed or to be formed, for the purpose of enjoying the benefits hereunder given, as may to him be deemed advisable;

(3) That each and all of the terms and conditions of this indenture shall be binding upon the heirs, personal representatives, successors and assigns of each and all of the parties hereto.

IN WITNESS WHEREOF, the parties hereto have executed these presents, in duplicate, the day and year hereinabove first written.

F. A. ANDREWS,
HAZEL WOLFF ANDREWS,
Parties of the First Part.
THOS. H. LIPPS,
Party of the Second Part.

Witness:
M. DAVIS JR. [81]

State of California,
County of Los Angeles—ss.

On this 10th day of February, 1922, before me, John Floyd, a Notary Public in and for said County and State, personally appeared G. A. ANDREWS and HAZEL WOLFF ANDREWS, his wife, known to me to be the persons whose names are subscribed to the foregoing instrument, and acknowledged to me that they executed the same.

WITNESS my hand and Notarial Seal.

[Seal] JOHN FLOYD,

Notary Public in and for the County of Los Angeles, State of California.

State of California,
County of Los Angeles—ss.

On this 10th day of February, 1922, before me, John Floyd, a Notary Public in and for said County and State, personally appeared THOMAS H. LIPPS, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same.

WITNESS my hand and Notarial Seal.

[Seal] JOHN FLOYD,

Notary Public in and for the County of Los Angeles, State of California. [82]

EXHIBIT 3.

KNOW ALL MEN BY THESE PRESENTS:

That I, Thomas H. Lipps, of the City of Los Angeles, County of Los Angeles, State of California, have and by these presents do sell, assign, transfer, convey and set over unto W. B. Allen, P. H. Greer, Henry J. Grohs, L. E. H. De Sallier, Thomas H. Lipps, as trustees for the Twin Bell Oil Syndicate, an unincorporated trust estate, all my right, title and interest in and to that certain oil and gas lease made and entered into on the 8th day of December, 1921, by and between W. O. Batson and Mabel Batson, his wife, covering the following described property, to-wit:

Lots two (2), three (3), four (4), five (5), six (6), seven (7) and eight (8) of Block Eighty-five (85), in the town of Santa Fe Springs, as per map recorded in Book 26, page 27, et seq., miscellaneous records of said County:

to F. A. Andrews, and also my right, title and interest to assignment of said lease made by F. A. Andrews to myself on or about the 10th day of February, 1922, which assignment was duly recorded in the office of the County Recorder, of Los Angeles County on the 11th day of February, 1922, in Book 944, page 34 of Official Records of Los Angeles County.

THIS ASSIGNMENT is made, executed and accepted upon condition that the said assignees, as trustees, for the said Twin Bell Oil Syndicate, shall fully and faithfully comply with all the terms and conditions required in the original lease herein set forth, and also with all the terms and conditions stipulated and set forth in the assignment of same to the said F. A. Andrews, and upon the further condition that the said trustees and the said Twin Bell Oil Syndicate shall and hereby do agree that as owners of all the units permitted to be issued by the Corporation Commissioner of the State of California, and required to be escrowed, shall not, in the event of dissolution or insolvency of said company, occurring while said unit shares shall be so required to be held in escrow, participate, as the owner of such escrowed unit shares, without the consent of the Commissioner of Corporations, in any distribution of assets of said [83] company until

after the owners of all other securities and units shall have been paid the full face value of same, and

Further, that the nominees named by the said trustees or any of them in any application made to the Corporation Commissioner of the State of California shall likewise enter into an agreement with such nominees that they will not, while such units are held in escrow, participate, in the event of insolvency, in any distribution of assets of said Syndicate or company, without the consent of the Commissioner of Corporations.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal this 25th day of April, 1922.

THOS. H. LIPPS [Seal].

The foregoing assignment and each and every provision thereof is hereby accepted upon the conditions, terms and stipulations herein contained.

TWIN BELL OIL SYNDICATE,
By WALTER B. ALLEN,
President and Trustee.
By THOS. H. LIPPS,
Secretary and Trustee.
L. E. H. De SALLIER,
P. H. GREER,
HENRY J. GROHS,
Trustees.

State of California,
County of Los Angeles—ss.

On this 28th day of April, 1922, before me, Daniel M. Potter, a Notary Public in and for the said

County and State, residing therein, duly commissioned and sworn, personally appeared Thomas H. Lipps, known to me to be the person whose name is subscribed to the within Instrument, and acknowledged to me that he executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this Certificate first above written.

[Seal] DANIEL M. POTTER,
Notary Public in and for said County and State. [84]

State of California,
County of Los Angeles—ss.

On this 28th day of April, 1922, before me, DANIEL M. POTTER, a Notary Public in and for said County and State, duly commissioned and sworn, personally appeared W. B. Allen, P. H. Greer, Henry J. Grohs, L. E. H. De Sallier, Thomas H. Lipps, known to me to be the persons whose names are subscribed to the within Instrument, accepting the aforesaid assignment, individually and as trustees for the Twin Bell Oil Syndicate, and they and each of them duly and severally acknowledged to me that he and they executed the same for themselves and on behalf of the Twin Bell Oil Syndicate and likewise subscribed their names thereto as trustees for the said Twin Bell Oil Syndicate.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal this 28th day of April, 1922.

DANIEL M. POTTER,
Notary Public in and for said County and State. [85]

EXHIBIT 4.

STATE CORPORATION DEPARTMENT OF THE STATE OF CALIFORNIA. PERMIT.

In the matter of the application of Ellwood De Garmo, Henry J. Grohs, James E. Mayberry, Thos. H. Lipps, Gilbert S. Sheets, Frank L. Martin and L. E. H. De Sallier, Trustees of an unincorporated association known as TWIN BELL OIL SYNDICATE for a certificate authorizing them to sell securities.

Thos. H. Lipps,
Attorney for Applicants.

Ellwood De Garmo, Henry J. Grohs, James E. Mayberry, Thos. H. Lipps, Gilbert S. Sheets, Frank L. Martin and L. E. H. De Sallier are trustees of a voluntary trust, expressly declared and created in an instrument in writing, to carry on business under the fictitious name of the "TWIN BELL OIL SYNDICATE". Under the terms of said instrument in writing, interests in the trust estate are represented by 3,000 unit shares, or a par value of $100 each.

The entire and exclusive title to and control of all the property, assets and business of this association are vested in a board of seven trustees.

The liability of the holders of these unit shares for debts to be created or incurred by the board of trustees is a matter for judicial determination.

Their application is for a certificate authorizing

them to issue and sell unit shares as follows: 1500 unit shares to Thos. H. Lipps, as part consideration, at this time, for the transfer to applicants of a leasehold interest, hereinafter described and 1500 unit shares at par, for cash, for the purpose of securing funds with which to drill for oil on said leased premises.

The leasehold interest is as follows: A lease dated December 8, 1921, for a period of 20 years, on approximately 1 1/3 acres, being Lots 2, 3, 4, 5, 6, 7 and 8 in Block 85 in the Town of Santa Fe Springs, Los Angeles County, California. Lease conditions require the commencing of actual drilling of an oil well within six months of date of lease. The lessee may extend the time for commencing a well by paying to lessor a rental of $100 per month for six months and $150 per month for the three months following, making a total of fifteen months from date of lease; and the payment of a royalty of one-fourth of all the oil and gas produced and saved on the premises.

APPLICANTS REPRESENT that this property is located approximately 1800 feet south of a producing well and that wells are being drilled on every side and in close proximity to this tract. [86]

Pursuant to their application, said trustees are permitted to issue and sell unit shares as follows:

1st 1500 unit shares at $100 each, for cash, lawful money of the United States, for the uses and purposes as recited in its application;

2nd Whenever and as often as a share or shares are sold under paragraph 1st, to issue

to Thos. H. Lipps a like number of unit shares, but not exceeding in the aggregate 1500 unit shares, as consideration for and upon the transfer first to be made to applicants of the leasehold interest hereinbefore described.

This permit is issued upon each of the following conditions:

(a) That, when issued, all certificates evidencing any of the unit shares in paragraph 2nd authorized to be issued to Thos. H. Lipps shall be deposited with a depositary, to be selected by said certificate holder and approved by the Commissioner of Corporations, to be held as an escrow pending the further order of said Commissioner; that the receipt of such depositary for such certificates shall be filed with said Commissioner of Corporation; and that while said certificates shall be so held, the holder of the unit shares evidenced thereby shall not sell or offer for sale, or otherwise transfer, or agree to sell or transfer such shares, until the written consent of said Commissioner shall have been obtained so to do;

(b) That the total commission, compensation and all other expense incurred in or connected with the sale of said 1500 unit shares in paragraph 1st authorized to be issued, shall not exceed 20 per cent of the amount paid in cash on account of such selling price, nor shall any commission or other compensation be paid in connection with any sale made within this state, except to a broker or agent holding a certificate from the Commissioner of Corpora-

tions, then in effect, authorizing him to act as applicants' agent;

(c) That the applicants shall agree with the purchaser of each unit share herein authorized that they will not sell any of their shares outside the State of California at less than the par value thereof for cash, nor pay in connection with the sale thereof any greater cost than 20 percent of such selling price;

(d) That this permit shall not become effective for any purpose unless and until said Thos. H. Lipps shall execute his agreement in writing with said company (and file a copy thereof with the Commissioner of Corporations) in which he shall, in effect, agree as owner of all or any part of 1500 unit shares in paragraph 2nd authorized to be issued to him, that in the event of the dissolution or insolvency of said company occurring while said unit shares shall be so required to be held in escrow, the owner of such unit shares shall not, without the consent of said Commissioner, while such [87] unit shares are required to be so held, participate in any distribution of assets of the company until after the owners of all other securities shall have been paid the full face or par value thereof;

(e) That a true copy of this permit be exhibited and delivered to each prospective subscriber for or purchaser of said securities before his subscription therefor shall be taken or any sale thereof made to him.

THE ISSUANCE OF THIS CERTIFICATE IS PERMISSIVE ONLY AND DOES NOT CON-

STITUTE A RECOMMENDATION OR ENDORSEMENT OF SAID SECURITIES.

Dated: Los Angeles, Calif.
February 18, 1932.

EDWIN M. DAUGHERTY,
Commissioner of Corporations.
By D. P. GOODWIN,
Deputy.

EXHIBIT 5.

STATE CORPORATION DEPARTMENT
OF THE
STATE OF CALIFORNIA.

AMENDED PERMIT.

In the matter of the application of Walter Allen, et al, Trustees of an unincorporated association known as TWIN BELL OIL SYNDICATE for a certificate authorizing them to sell securities.

Thos. H. Lipps,
Attorney for Applicants.

Upon application, the permit heretofore issued to the trustees of the TWIN BELL OIL SYNDICATE under date of February 18, 1922, is amended to read as follows:

Walter B. Allen, P. H. Greer, L. E. H. De Sallier, Henry J. Grohs and Thomas H. Lipps, the applicants, are trustees proposing to execute a voluntary trust, expressly declared and created in an instrument in writing, to carry on business under

the fictitious name of the "Twin Bell Oil Syndicate." Under the terms of said instrument in writing, interests in the trust estate are represented by 3,000 unit shares, of a par value of $100 each.

The entire and exclusive title to and control of all the property and assets of this association are vested in a board of seven trustees.

The liability of the holders of these unit shares for debts to be created or incurred by the trustees is a matter for judicial determination.

Their application is for a certificate authorizing them to issue and sell unit shares as follows: 1500 unit shares to Thomas H. Lipps, as consideration for the transfer to applicants of a leasehold interest, hereinafter described, and 1500 unit shares at par, for cash, for the purpose of securing funds with which to drill for oil on said leased premises.

The leasehold interest is as follows: A lease dated December 8, 1921, for a period of 20 years, on approximately 1 1/3 acres, being Lots 2, 3, 4, 5, 6, 7 and 8 in Block 85 in the town of Santa Fe Springs, Los Angeles County, California. Lease conditions require the commencing of actual drilling of an oil well within six months from date of lease. The lessee may extend the time for commencing a well by paying to lessor a rental of $100 per month for six months and $150 per month for the three months following, making a total of fifteen months from date of lease, and the payment of a royalty of one-fourth of all the oil and gas produced and saved on the premises.

APPLICANTS REPRESENT THAT:

This property is located approximately 1800 feet south of a producing well and that wells are being drilled on every side and in close proximity to this tract.

Pursuant to their application, said trustees are permitted to issue and sell unit shares as follows: [88]

> 1st: 1500 unit shares at $100 each, for cash, lawful money of the United States, for the uses and purposes hereinbefore recited;
>
> 2nd: Whenever and as often as a share or shares are sold under authority of paragraph 1st hereof, to issue to Thomas H. Lipps a like number of unit shares, but not exceeding in the aggregate hereunder 1500 unit shares, as consideration for and upon the transfer to applicants, first to be made, of the leasehold interest hereinbefore described.

This permit is issued upon each of the following conditions:

(a) That, when issued, all certificates evidencing any of the 1500 unit shares in paragraph 2nd authorized to be issued to Thomas H. Lipps shall be deposited with a depositary, to be selected by said certificate holder and approved by the Commissioner of Corporations, to be held as an escrow pending the further order of said Commissioner; that the receipt of such depositary for such certificates shall be filed with said Commissioner of Corporations; and that while said certificates shall be so

held, the holder of the unit shares evidenced thereby shall not sell or offer for sale, or otherwise transfer, or agree to sell or transfer such shares, until the written consent of said Commissioner shall have been obtained so to do;

(b) That the total commission, compensation and all other expense incurred in or connected with the sale of said 1500 unit shares in paragraph 1st authorized to be issued, shall not exceed 20 per cent of the amount paid in cash on account of such selling price, nor shall any commission or other compensation be paid in connection with any sale made within this state, except to a broker or agent holding a certificate from the Commissioner of Corporations, then in effect, authorizing him to act as applicants' agent.

(c) That the applicants shall agree with the purchaser of each unit share herein authorized that they will not sell any of their shares outside the State of California at less than the par value thereof for cash, nor pay in connection with the sale thereof any greater cost than 20 per cent of such selling price;

(d) That this permit shall not become effective for any purpose unless and until said Thomas H. Lipps shall execute his agreement in writing with said company (and file a copy thereof with the Commissioner of Corporations) in which he shall, in effect, agree as owner of all or any part of 1500 unit shares in paragraph 2nd authorized to be issued to him, that in the event of the dissolution or insolvency of said company occurring while

said unit shares shall be so required to be held in escrow, the owner of such unit shares shall not, without the consent of the said Commissioner, while such unit shares are required to be so held, participate in any distribution of assets of the company until after the owners of all other securities shall have been paid the full face or par value thereof;

(e) That no more than $5,000 aggregate par value of the securities herein authorized shall be sold, or agreed to be sold to any person or company; nor shall the applicants execute any contract or agreement with any person or company for the underwriting of the securities herein authorized or for their sale [89] and issuance to a company, broker, or other person who agrees to purchase said securities for the purpose of reselling them or of offering them for sale to the public at a profit, until the written approval of the Commissioner shall be obtained;

(f) That all subscriptions for any of the unit shares authorized in paragraph 1st to be sold for money, shall be taken upon subscription blanks, of a form to be first submitted to and approved by the Commissioner of Corporations. This permit shall be printed in full upon the reverse side of said subscription blanks.

1. Each subscription for any of the unit shares shall be upon the express condition that unless bona fide subscriptions for 937½ shares shall have been obtained from responsible subscribers on or before the 18th day of August, 1922, such subscription may by such subscriber

be, and thereupon shall be, deemed to have been rescinded.

2. That the full amount of each payment made by a subscriber shall be paid to the applicants, and not more than 20 per cent thereof may be expended by the applicants for commissions to their duly authorized agents and for other expenses relating to the sale of the securities herein authorized. The balance of each payment, and a statement showing the full name and address of each subscriber, and the number of unit shares subscribed for by each subscriber, shall immediately be paid and delivered by the applicants to a depositary, to be first selected by the applicants and approved by the Commissioner of Corporations. If, on or before the 18th day of August, 1922, there shall have been deposited with such depositary the net sum of $75,000, it shall be paid and delivered by the depositary to the applicants upon their demand therefor and the written order of said Commissioner; otherwise, 80 per cent of each payment made by each subscriber, being the sum so deposited with said depositary, shall be returned to him upon his demand therefor and his subscription shall be cancelled.

(g) That a true copy of this permit be exhibited and delivered to each prospective subscriber for or purchaser of said securities before his subscription therefor shall be taken or any sale thereof made to him.

THE ISSUANCE OF THIS CERTIFICATE IS PERMISSIVE ONLY AND DOES NOT CONSTITUTE A RECOMMENDATION OR ENDORSEMENT OF SAID SECURITIES.

Dated: Los Angeles, Cal.,
May 17, 1922.

EDWIN M. DAUGHERTY,
Commissioner of Corporations.
By A. G. FICKEISEN,
Chief Deputy. [90]

DWM:CL

EXHIBIT 6.

STATE CORPORATION DEPARTMENT
OF THE
STATE OF CALIFORNIA.

AMENDMENT TO PERMIT.

In the matter of the application of Ellwood De Garmo, Henry J. Grohs, James E. Mayberry, Thos. H. Lipps, Gilbert S. Sheets, Frank L. Martin and L. E. H. De Sallier, Trustees of an unincorporated association known as TWIN BELL OIL SYNDICATE for a certificate authorizing them to sell securities.

Thos. H. Lipps,
Attorney for Applicants.

Upon application, the permit heretofore issued to the trustees of the TWIN BELL OIL SYNDICATE under date of February 18, 1922, is amended in the following respects:

The fifth paragraph, appearing on page 1, and conditions (e) and (f), appearing on pages 3 and 4, are eliminated.

This amendment to permit is issued upon the condition that a true copy of the permit issued under date of February 18, 1922, as hereby amended, be exhibited and delivered to each prospective subscriber for or purchaser of said securities before his subscription therefor shall be taken or any sale thereof made to him.

Dated: Los Angeles, Cal.
March 7, 1922.

[Seal] EDWIN M. DAUGHERTY,
Commissioner of Corporations.
By D. P. GOODWIN,
Deputy.

RJS:CL [91]

EXHIBIT 7.

COPY.

THIS AGREEMENT made and entered into this 27th day of April, 1922, by and between the TWIN BELL OIL SYNDICATE, an unincorporated association, operating under and by virtue of a declaration of trust, dated on or about the 17th day of February, 1922, and duly recorded in the office of the County Clerk of Los Angeles County, having its office and principal place of business in the City of Los Angeles, County of Los Angeles, party of the first part, and the Keck Drilling Corporation, a corporation, hereinafter called second party.

WITNESSETH:

That WHEREAS the first party is the owner in possession of that certain oil and gas lease dated the 8th day of December, 1921, executed by

W. A. Batson and wife, as Lessors, to F. A. Andrews, Lessee, recorded in book 838, page 140 of Leases, Records of Los Angeles County; and

WHEREAS first party desires to contract with second party to drill upon the premises described in said lease a well for oil and/or gas and has agreed with second party upon the price, terms and conditions for the drilling thereof;

NOW THEREFORE, for and in consideration of the premises and the mutual covenants and promises hereinafter contained, the parties hereto agree as follows:

First party hereby contracts with second party for the drilling of, and second party hereby contracts with first party to drill a well for oil and/or gas on the premises described in said lease.

Second party agrees to commence actual drilling of said well as a turnkey job with a rotary drilling outfit within thirty-five (35) days from the date hereof and thereafter prosecute the drilling thereof continuously in good faith to a depth of forty-three hundred (4300) feet unless oil and/or gas is encountered in paying quantities at a lesser depth. It is specifically under- [92] stood, however, that the party of the second part shall have its derrick fully completed including steel crown block within fifteen (15) days from the date of execution hereof.

First party shall furnish all water necessary in connection with drilling operations aforesaid, but the second party agrees, subject to the provisions hereinafter contained, to furnish and supply at its sole cost and expense all fuel, gas, material, labor,

equipment and supplies necessary or incident to the drilling of said well, including the cementing off of same.

The first party agrees to pay to second party, and second party agrees to accept as compensation for the drilling of said well, the sum of One Hundred Twenty-five Thousand ($125,000.00) Dollars, payable as follows, to-wit: the party of the first part shall deposit with the Farmers & Merchants National Bank of Los Angeles, upon the execution of this agreement, the sum of Twenty-five Thousand (25,000.00) Dollars with instructions to the said Farmers & Merchants National Bank to pay to the party of the second part the said sum of Twenty-five Thousand ($25,000.00) Dollars when the said second party has landed in said well a string of fifteen and one-half (15½) inch casing. Immediately upon the payment of said Twenty-five Thousand ($25,000.00) Dollars, the party of the first part shall deposit a second Twenty-five Thousand ($25,000.00) Dollars with instructions to the said Farmers & Merchants Bank to pay the aforesaid sum to the second party when the said second party has landed in said well a string of ten (10) inch casing. And immediately upon the payment of the said sum of Twenty-five Thousand ($25,000.00) Dollars, as herein set forth, the party of the first part shall likewise deposit a third sum of Twenty-five Thousand ($25,000.00) Dollars, with instructions to the said Farmers & Merchants Bank to pay the same to the party of the second part when the said second party shall have set a string

of eight and one-quarter (8¼) inch casing, landed same cemented it in and has caused the cement to be drilled through. [93]

Provided, however, if second party succeeds in carrying the ten (10) inch string of casing to a point in said well just above the oil bearing formation, cements the same in as a water string, causes the cement to be drilled through and on test secures a water shut-off, first party shall thereupon pay to second party the then balance of Seventy-five Thousand ($75,000) Dollars, to-wit, the sum of Fifty Thousand ($50,000) Dollars. If second party fails to secure a water shut-off with said ten (10) inch string so landed and cemented, first party shall pay to second party, upon a showing that the water is not shut off with said ten (10) inch string, the sum of Twenty-five Thousand ($25,000) Dollars and second party shall proceed to put into said well an eight and one-quarter (8¼) inch string, land the same, cement it off, and upon drilling through said cement, shall be entitled to and shall receive the then balance of Seventy-five Thousand ($75,000) Dollars, to-wit, the sum of Twenty-five Thousand ($25,000.00) Dollars, whether it is successful in shutting off said water with said eight and one-quarter (8¼) inch string or not, the understanding and agreement being that second party shall be entitled to and shall receive sums aggregating Seventy-five Thousand ($75,000) Dollars in cash, first, if and when it succeeds in getting a water shut-off with a ten inch (10) inch casing, or failure so to do, lands an eight and one-quarter (8¼) inch string,

cements the same off and causes the cement to be drilled through.

Second party agrees to give one days' notice to first party of its intention to call upon said bank for the payment of any installment hereinabove agreed to be made, stating in said notice that the condition precedent to the right to receive such installment payment has been complied with, to-wit, the landing of a string of casing, its diameter, the point at which the same is landed, and the amount of said installment payment.

The balance of said sum of One Hundred Twenty-five [94] thousand ($125,000) Dollars shall be paid to second party by first party from the proceeds of the sale of oil produced on said premises as follows: From the gross run of oil there shall be deducted twenty-five (25%) per cent reserved by prior lessors of said property. The balance, or seventy-five (75%) per cent, shall be divided between the parties hereto, and the party of the first part shall be entitled to receive one-fourth (¼) thereof out of which it shall pay the costs of maintenance and operation of said well, and the party of the second part shall receive the balance, or three-fourths (¾) of said oil, until the sum of Fifty Thousand ($50,000) Dollars, the equivalent or balance of said contract price, shall have been paid to it; provided, however, if second party discovers oil in paying quantities at a depth less than forty-three hundred (4300) feet, then the contract price herein agreed to be paid for the drilling of said well shall

be reduced by a sum equal to fourteen ($14.00) Dollars per foot for the number of feet between forty-three hundred (4300) feet and such lesser depth as said well is completed, such reductions in said contract price to come out of final payments.

Said well shall be deemed to be a completed well within the meaning of this agreement when the same shall have been drilled to a depth of forty-three hundred (4300) feet without encountering oil and/or gas in paying quantities, or when at a lesser depth oil and/or gas has been encountered in paying quantities and said well put upon the production list, provided, however, if at forty-three hundred (4300) feet no oil and/or gas has been encountered first party shall be entitled to take over the well in its then condition and proceed to the drilling thereof to a greater depth, but at its sole cost and expense, and if oil and/or gas is not encountered at such greater depth, such well shall be salvaged by second party and the proceeds thereof shall be paid to and retained by it together with the Seventy-five Thousand ($75,000) Dollars theretofore paid in full compensation for the drilling of said well. In the event [95] oil and/or gas is encountered in paying quantities in said well at such greater depth such well shall be properly cased and put upon the production list. The material and supplies necessary to properly case said well below the depth of forty-three hundred (4300) feet and the casing thereof shall be paid for by first party, and the casing, supplies and equipment required in said well at said forty-three

hundred (4300) feet depth shall be furnished and supplied by second party and at its sole cost and expense.

Second party agrees to employ skilled workmen and approved methods in all its operations hereunder, and that all equipment and materials used by it shall be in first class order and condition, and fitted for the uses and purposes to which they are put.

Second party shall use in casing said well fifteen and one-half (15½) inch, seventy pound (70) casing; ten (10) inch, forty-five (45) pound casing; eight and one-quarter (8¼) inch, thirty-six (36) pound casing and six and one-quarter (6¼) inch twenty-six (26), or twenty-eight (28) pound casing, to the extent necessary to put well on production.

Second party further agrees that in attempting to shut off water in said well it shall use the modern and approved methods and equipment, and employ in the work thereof workmen skilled in the work of handling and shutting off water in oil wells, but nothing in this paragraph or in this agreement shall be construed as a guarantee or an agreement on the part of second party to successfully and completely shut off water in said well, but second party does agree to use its best endeavors to do so.

In the event of the loss of said well herein agreed to be drilled before completion or before the required depth has been reached, second party shall forthwith commence the drilling of another well as near the same location as is reasonably safe and possible to do, and prosecute the drilling thereof

to completion without additional charge to or compensation from first party. [96]

It is understood, however, that if the loss of said well is caused by flow of water in unusual quantities or with such force as to render the same impossible of control, the second party shall be entitled to and shall receive from first party the actual cost for abandoned well and the balance of such net cost that has heretofore been paid by first party to second party shall be credited on the price of the new well which shall be drilled for the same price and upon the same terms and conditions as herein provided for the drilling of the well so lost or abandoned, provided, however, that in the event of the loss of such first well from flow of water, impossible of control, as herein set forth, either party may cancel the agreement as to the drilling of another well and all sums heretofore paid to second party shall, together with salvage of said well, be retained by second party as compensation to it for the drilling thereof.

It is understood that in the event a blowout occurs, the second party shall not be responsible for damage to surrounding property.

On the completion of said well, second party may remove from the premises all boilers, steam lines, drilling equipment, tools and unused casing placed on the premises by second party but all supplies, material and equipment placed thereon by second party and customarily used or required in the operation of oil and gas wells, including the twelve by

twelve (12x12) standard engine, sand line and sand reel, shall be left on said premises and shall be, become and remain the property of first party.

In the event second party in the drilling to completion of said well encounters bottom water, it shall proceed by approved methods to shut the same off, the cost and expense of which shall be charged to first party and added to the contract price of such well and paid out of proceeds received from the sale of oil and/or gas produced from said well. [97]

First party further agrees to furnish, supply and install at its sole cost and expense all gas traps and necessary tanks to receive and care for production.

Second party agrees in the event a well drilled by it hereunder is a flowing well that it shall connect the same with first party's flow lines. In the event it is necessary to use tubing, rods and pump in order to make such well a producer, such tubing, rod and pump shall be furnished and supplied at the expense of first party and be installed by and at the expense of second party.

The second party shall keep accurate logs, records and measurements of the progress of said well which shall at all times be available to the first party; shall likewise carry and maintain in full force and effect at its own cost and expense liability, accident and workingmen's compensation insurance and shall at all times keep the premises and drilling operations free and clear of any liens and encumbrances in connection with its operations.

Nothing in this contract contained shall be construed as giving the contractor possession of said land and in event of the abandoning of the second party it shall execute to the first party a quitclaim deed to the lease and premises in question.

Both parties agree that time is the essence of this contract and in the event the second party shall fail to commence drilling operations within thirty-five (35) days in accordance with the terms and intent of this contract, the party of the first part shall be entitled to and shall receive the benefit of all the work, labor and services performed and materials furnished by the first party in connection with the drilling of said well up to the time of said breach, but first party shall be obligated to pay therefor the actual amount of cost thereof.

The first party agrees to keep the well, after same has been placed on production, as herein set forth, in good condition [98] and repair and continue so that said well shall produce a maximum amount of oil.

It is expressly understood and agreed by and between the parties hereto that strikes, lockouts, acts of God and conditions over which second party has no control shall severally be taken as sufficient excuse for any delay or interruption in the continuous prosecution by second party of the drilling of said well, and any delay or interruption of drilling operations so caused shall not be deemed as a breach of any of the covenants herein contained to be performed by said party.

IN WITNESS WHEREOF the parties hereto have caused this agreement to be executed the day and year first above written.

TWIN BELL OIL SYNDICATE,
By WALTER B. ALLEN,
President.

[Seal] Attest:
THOS. H. LIPPS,
Secretary.

KECK DRILLING CORPORATION
[Seal] By WALTER O. ABBOTT,
President.

Attest:
GERTRUDE E. SAXE,
Secretary. [99]

EXHIBIT 8.

COPY.

THIS AGREEMENT, made and entered into this 8th day of June, 1922, by and between the TWIN BELL OIL SYNDICATE, an unincorporated association, operating under and by virtue of a declaration of trust, dated on or about the 17th day of February, 1922, and duly recorded in the office of the County Clerk of Los Angeles County, having its office and principal place of business in the City of Los Angeles, County of Los Angeles, party of the first part, and the KECK DRILLING CORPORATION, a corporation, hereinafter called second party.

WITNESSETH:

That WHEREAS the first party is the owner in

possession of that certain oil and gas lease dated the 8th day of December, 1921, executed by W. A. Batson and wife, as Lessors, to F. A. Andrews, Lessee, recorded in Book 838, page 140 of Leases, Records of Los Angeles County; and

WHEREAS, first party desires to contract with second party to drill upon the premises described in said lease a well for oil and/or gas and has agreed with second party upon the price, terms and conditions for the drilling thereof;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants and promises hereinafter contained, the parties hereto agree as follows:

First party hereby contracts with second party for the drilling of, and second party hereby contracts with first party to drill a well for oil and/or gas on the premises described in said lease.

First party agrees to furnish, erect and supply at the site of said proposed well a derrick and rig irons complete and in place, and further agrees to furnish all water necessary for the drilling of said well.

Second party agrees to commence actual drilling of said well as a turnkey job with a rotary drilling outfit within twenty [100] (20) days from the date hereof, and thereafter prosecute the drilling thereof continuously in good faith to a depth of forty-three hundred (4300) feet unless oil and/or gas is encountered at a lesser depth in paying quantities, as hereinafter defined.

"Paying quantities" or a "well producing oil in

paying quantities" is hereby defined to be a well that will produce an average of one hundred barrels per day of twenty-four (24) hours for the twenty (20) days next succeeding the date upon which said well may be placed upon the production list.

Second party further agrees, subject to the provisions hereinafter contained, to furnish and supply at its sole cost and expense, all fuel, gas, material, labor, equipment and supplies (except derrick and rig irons) necessary or incident to the drilling of said well, including the cementing off of the same.

First party agrees to pay to second party, and second party agrees to accept as compensation for the drilling of said well, the sum of One Hundred and Fifty Thousand Dollars ($150,000), payable as follows, to-wit:

The party of the first part shall deposit with the Farmers & Merchants National Bank of Los Angeles, upon the execution of this agreement, the sum of Thirty Thousand Dollars ($30,000), with instructions to said Farmers & Merchants National Bank to pay to the party of the second part the sum of [illegible] have been notified by second party that said well has been spudded in, and Ten Thousand Dollars ($10,000) when they have been notified by second party that it has landed in said well either a fifteen and one-half (15½) inch casing, or a twelve and one-half (12½) inch casing.

It is mutually understood and agreed that the second party may use as a first string either a fifteen and one-half (15½) inch casing, or a twelve and

one-half (12½) inch casing at its election and as a second string either ten (10) inch or eight and one-quarter [101] (8¼) inch casing. If in the completion of said well it is necessary to use six and one-quarter (6¼) inch casing the same shall be twenty-six (26) or twenty-eight (28) pounds per foot.

Second party agrees to give one day's notice to first party of its intention to call upon said Bank for the payment of any installment hereinabove agreed to be made, stating in said notice that the condition precedent to the right to receive such installment payment has been complied with, to-wit, the spudding in of said well, and in the case of the second payment, the landing of a fifteen and one-half (15½) inch or twelve and one-half (12½) inch casing.

The balance of said sum of One Hundred and Fifty Thousand Dollars ($150,000), to-wit, the sum of One Hundred and Twenty Thousand Dollars ($120,000), shall be paid to second party by first party from the proceeds of the sale of oil produced on said premises as follows: From the gross proceeds received from the sale of oil produced, saved and sold from said premises there shall be deducted the royalty due the lessors, and the balance of said gross proceeds shall be divided between the parties hereto, one-fourth thereof to first party, out of which it shall pay the cost of operation and maintenance of said wells, and three-fourths thereof to second party, until second party has been paid the full balance of the contract price, to-wit, the sum of One Hundred and Twenty Thousand Dollars ($120,-

000); provided, however, if second party discovers oil in paying quantities at a depth less than forty-three hundred (4300) feet, then the contract price herein agreed to be paid for the drilling of said well shall be reduced by a sum equal to Fourteen Dollars ($14.00) per foot for the number of feet between forty-three hundred (4300) feet and such lesser depth as said well is completed, such reductions in said contract price to come out of final payments.

Said well shall be deemed to be a completed well within the meaning of this agreement when the same shall have been drilled to a depth of forty-three hundred (4300) feet with or without encountering [102] oil and/or gas in paying quantities, or when at a lesser depth oil and/or gas has been encountered in paying quantities and said well put upon the production list, provided, however, if at forty-three hundred (4300) feet no oil and/or gas has been encountered first party shall be entitled to take over the well in its then condition and proceed to the drilling thereof to a greater depth, but at its sole cost and expense, and if oil and/or gas is not encountered at such greater depth, such well shall be salvaged by second party and the proceeds thereof shall be paid to and retained by it, together with the Thirty Thousand Dollars ($30,000) theretofore paid in full compensation for the drilling of said well. In the event oil and/or gas is encountered in paying quantities in said well at such greater depth such well shall be properly cased and put

upon the production list, but at the sole cost and expense of first party.

Second party agrees to employ skilled workmen and approved methods in all its operations hereunder, and that all equipment and materials used by it shall be in first class order and condition, and fitted for the uses and purposes to which they are put.

Second party shall use in casing said well fifteen and one-half (15½) inch, seventy (70) pound casing, or twelve and one-half (12½) inch, 45 pound casing; ten (10) inch, forty-five (45) pound casing, or eight and one-quarter (8¼) inch, thirty-six (36) pound casing, and six and one-quarter (6¼) inch, twenty-six (26) or twenty-eight (28) pound casing, to the extent necessary to put well on production, except as hereinabove provided.

Second party further agrees that in attempting to shut off water in said well, it shall use the modern and approved methods and equipment, and employ in the work thereof workmen skilled in the work of handling and shutting off water in oil wells, but nothing in this paragraph or in this agreement shall be construed as a guarantee or an agreement on the part of second party to successfully and completely shut off water in said well, but second party does agree [103] to use its best endeavors to do so.

In the event of the loss of said well herein agreed to be drilled before completion or before the required depth has been reached, second party shall forthwith commence the drilling of another well as near the same location as is reasonably safe and pos-

sible to do, and prosecute the drilling thereof to completion without additional charge to or compensation from first party.

It is understood, however, that if the loss of said well is caused by flow of water in unusual quantities, or with such force as to render same impossible of control, the second party shall be entitled to, and shall receive from first party, the actual cost of such abandoned well, and if the actual cost exceeds the cash payments herein made, such excess shall be paid out of oil produced from said leased premises. In the event that first party has paid to second party on account of said well at the time of such loss or abandonment, a sum of money in excess of its actual cost, such excess shall be credited by first party on account of the contract price of the new well, which shall be drilled for the same price and upon the same terms and conditions as herein provided for the drilling of the well so lost or abandoned; provided, however, that in the event of the loss of said first well from flow of water impossible of control, as herein set forth, either party may cancel the agreement as to the drilling of another well, and all sums heretofore paid to second party shall, together with the salvage of said well, be retained by second party as compensation to it for the drilling thereof, and such salvage shall be accepted and received by second party in full payment for the drilling of such lost or abandoned well.

It is understood, however, that in the event a blowout occurs, the second party shall not be responsible for damage to surrounding property.

On the completion of said well, second party may remove from the premises all boilers, steam lines, drilling equipment, tools [104] and unused casing placed on the premises by second party, but all supplies, material and equipment placed thereon by second party and customarily used or required in the operation of oil and gas wells, including the twelve by twelve (12 x 12) standard engine, sand line and sand real, shall be left on said premises and shall be, become and remain the property of first party, all without cost to first party.

In the event second party in the drilling to completion of said well encounters intermediate or bottom water, it shall proceed by approved methods to shut the same off, the cost and expense of which shall be charged to first party and added to the contract price of said well and paid out of the proceeds received from the sale of oil and/or gas produced from said well, it being understood and agreed that any water encountered after passing through any oil bearing formation shall be construed within the meaning of this paragraph as intermediate or bottom water.

First party further agrees to furnish, supply and install at its sole cost and expense all gas traps and necessary tanks to receive and care for production.

Second party agrees in the event a well drilled by it hereunder is a flowing well, that it shall connect the same with first party's flow lines. In the event it is necessary to use tubing, rods and pump in order to make any such well a producer, such tubing, rods and pump shall be furnished and supplied at the expense of first party and be installed by and at the expense of second party.

The second party shall keep accurate logs, records, and measurements of the progress of said well, which shall at all times be available to the first party; shall likewise carry and maintain in full force and effect at its own cost and expense liability, accident and workingmen's compensation insurance and shall at all times keep the premises and drilling operations free and clear of any liens and encumbrances in connection with its operations. [105

Nothing in this contract contained shall be construed as giving the contractor possession of said land and in the event of the abandoning of the second party it shall execute to the first party a quit-claim deed to the lease and premises in question.

Both parties agree that time is the essence of this contract and in the event the second party shall fail to commence drilling operations within twenty (20) days in accordance with the terms and intent of this contract, the party of the first part shall be entitled to and shall receive the benefit of all the work, labor and services performed and materials furnished by the first party in connection with the drilling of said well up to the time of said breach, but first party shall be obligated to pay therefor the actual amount of cost thereof.

First party agrees to keep said well after the same has been placed on the production list, and so long as any portion of the contract price herein agreed to be paid to the second party remains unpaid, in good condition and repair so that said well shall produce a maximum amount of oil.

The parties hereto under date of the 27th day of April, 1922, entered into a contract for the drilling of a well on the premises described in said lease upon the terms and conditions set forth in said contract, copies of which are in the possession of each of the parties hereto, and to which reference is hereby made for terms and conditions, and it is hereby expressly understood and agreed that in the event that either well is completely paid for according to the terms of the respective contracts before the other well is completed, then and in that event the same percentage of the gross proceeds received from the sale of oil produced, saved and sold from such completed well shall be paid into the Farmers & Merchants National Bank until the payments so made shall equal that portion of the contract price of said uncompleted well that is payable from the proceeds from the sale of oil, and on the completion [106] of the second well, if the same is completed as a well producing oil in paying quantities, shall be paid over to second party, the understanding and agreement being that second party shall be entitled to such percentage of the gross proceeds received from the sale of oil and/or gas produced, saved and sold from either well until the contract price on both wells have been paid.

It is further understood and agreed that all deferred payments shall bear interest at the rate of four per cent per annum from date of completion of any well, but second party shall not be entitled to interest on any sum or sums deposited or impounded

in the Farmers & Merchants National Bank, or any other bank, for the benefit of second party and it is further understood and agreed that the total cash cost of the wells to be drilled by the second party in accordance with both the first contract entered into and this contract shall not exceed the sum of One Hundred and Five Thousand Dollars ($105,000), and that the balance of the cost of drilling said well, to-wit, the sum of One Hundred and Seventy Thousand Dollars ($170,000) and interest thereon, as well as any and all other additional charges that may become due and owing to the party of the second part for any reason whatever in connection with either of the aforesaid wells, shall be payable out of oil produced from either or both wells in accordance with the provisions hereof.

It is expressly understood and agreed by and between the parties hereto that strikes, lockouts, Acts of God and conditions over which second party has no control shall severally be taken as sufficient excuse for any delay or interruption in the continuous prosecution by second party of the drilling of said well, and any delay or interruption of drilling operations so caused shall not be deemed as a breach of any of the covenants herein contained to be performed by second party. [107]

IN WITNESS WHEREOF, the parties hereto

have caused this agreement to be executed the day and year first above.

TWIN BELL OIL SYNDICATE
By W. B. ALLEN
President.
And THOS. H. LIPPS
Secretary

[Seal] KECK DRILLING CORPORATION
By WALTER O. ABBOTT
President.
And GERTRUDE E. SAXE
Secretary

[Seal] [108]

EXHIBIT 10

COPY

THIS AGREEMENT Made and entered into this 31st day of March, 1923, by and between TWIN BELL OIL SYNDICATE, an unincorporated association operating under and by virtue of a declaration of trust dated on or about the 17th day of February, 1922, and duly recorded in the office of the County Clerk, Los Angeles County, having its office and principal place of business in the City of Los Angeles, County of Los Angeles, hereinafter called "Syndicate", and the W. M. KECK DRILLING COMPANY, a corporation, hereinafter called "Company",

WITNESSETH:

THAT WHEREAS, the Syndicate is the owner of that certain oil and gas lease dated the 8th day of December, 1921, executed by W. A. Batson and

wife, as lessors, to F. A. Andrews, as lessee, recorded in Book 838, page 140 of Leases, Records of Los Angeles County; and

WHEREAS, the Syndicate has caused to be drilled on said leased premises a well known and referred to as Twin Bell No. 2, to the approximate depth of 3776 feet, and caused to be placed and cemented therein an 8¼ inch 36 pound casing at the approximate depth of 3687 feet, and caused to be placed in said well a 3 inch string of tubing hanging free in the well at an approximate depth of 3300 feet; and

WHEREAS, the Syndicate desires to contract with the Company to drill said well into the Meyer sand, complete and place said well upon the production list, and has agreed with the Company upon the contract price for undertaking, and the terms and conditions under which it will undertake to so complete and place said well upon the production list;

NOW, THEREFORE, for and in consideration of the premises, the parties hereto agree as follows:

1. The Company agrees to commence deepening operations on said well with a full complement of fifteen men, steam up and [109] complete machinery and rotary equipment installed and operations actually started on or before April 9th, 1923, and thereafter with reasonable diligence and in good faith proceed to remove from said well and lay down said 3 inch tubing.

2. The Company agrees following removal and laying down said string of 3 inch tubing, to proceed with the drilling of said well into the said Meyer

sand to an approximate depth of 4525 ft, and in drilling and completing said well agrees to land a string of 6¼ inch casing above said Meyer sand at the approximate depth of 4100 feet, cement off the water and the Bell sand, and finish said well with a string of 4-¾ inch casing landed at approximately 4525 feet; provided, however, that nothing in this paragraph or in this agreement contained shall be construed as an agreement or guaranty on the part of the Company to successfully so land and cement said 6¼ inch casing, shut off the water and the Bell sand or to land said 4-¾ inch casing at the approximate depth of 4525 feet, the understanding and agreement in this regard being that the company shall use its best efforts so to do, and agrees to employ skilled workmen and improved methods in all its operations hereunder, and that all equipment and materials used by it shall be in first class order and condition, and fitted for the uses and purposes to which they are put. If the Company is unable, after reasonable effort, to land the said 6¼ inch casing and cement off said water and the Bell sand therewith, it shall be permitted to proceed with the drilling of said well and finish the same with a 4-¾ inch casing as a combination string. The intent of this paragraph being that the Company shall use its best efforts and all modern methods to land and cement a 6¼ inch string before resorting to the combination string. All cementing to be done at the cost and expense of the Company.

If the Company shall find said well not to be in the condition represented by the Syndicate, and more

particularly [110] to-wit, if the 8¼ inch string is not in condition to be drilled through, and for the passage of a 6¼ inch string of casing, or if the 3 inch tubing is not hanging free in said well, the cost of removing said three inch tubing and the cost of such repairs and work as may be necessary to enable the passage of the 6¼ inch casing through the 8¼ inch, shall be borne by the Syndicate and the net cost thereof to the Company shall be added to the contract price for completing said well, as hereinafter stated.

3. The Company agrees to furnish and supply at its sole cost and expense all machinery, equipment, tools and materials of every kind and nature, and fuel, and all labor necessary or incident to the completion of said well. The Syndicate shall furnish water. It is agreed, however, that the Company shall have the free use of the derrick equipment and such materials, supplies and machinery as are now at said well and belonging to the Syndicate, but the title thereto shall continue to vest in the Syndicate.

4. In the event it is decided to drill said well to a greater depth than 4525 feet said drilling shall be done by the Company and paid for by the Syndicate at the rate of $40.00 per foot. The Company shall not be required to drill under this provision of the contract to a greater depth than 4650 feet.

The Company shall leave on said well when completed such equipment and supplies as may be necessary to operate said well as a producing well, and shall in no event remove any equipment or supplies at present owned by the Syndicate. The Company

shall furnish to the Syndicate at its request one free core to be taken at any point indicated by the Syndicate, but all other cores required by the Syndicate and furnished by the Company shall be paid for at the rate of $350.00 per day for actual time in securing such additional cores.

5. The Syndicate agrees to pay the Company for the completion of said well and putting same upon the production list [111] the full sum of $75,000.00, payable out of oil and gas produced from said well, as follows:

There shall be paid to the Company by the Syndicate 60% of the gross proceeds received from the sale of oil and/or gas produced, saved and sold from said well until the full sum of $75,000.00 and such additional sums as may be due the Company hereunder shall have been paid to and received by it without interest, except in the event the payment to the Company of said 60% of said proceeds is interrupted for any cause or because of any controversies or disagreements between the Syndicate and the Company, then and in that event said contract price shall bear interest at the rate of 6% per annum from the expiration of thirty days from the date upon which said well is turned over to the Syndicate to the date upon which final payment of said contract price shall have been made as herein provided.

All said payments to be made by the Syndicate to the Company monthly as and when received from the pipe line company.

6. The well shall be deemed to be completed and on the production list within the meaning of this

agreement when said well has produced oil in paying quantities for twenty-four consecutive hours after said oil string has been landed.

7. The Company shall furnish at its sole cost and expense, and install all gates, fittings, valves and equipment required to place said well on the production list as a flowing well from casing head to the edge of the derrick floor. All other equipment required, including tubing, pumps and succor rods if the same be required to make the well a producing well shall be furnished by the Syndicate and installed by the Company. All gates, valves and fittings shall be of sufficient weight to withstand a gas pressure of 1600 pounds per square inch.

The Company shall conduct its operations continuously by day and night in good faith to completion, and if for any reason [112] the Company shall abandon said well and discontinue operations before completion, then the Syndicate shall not be obligated to the Company for any payment whatever, but in the event of such abandonment the Company shall have the right to remove all material, machinery and equipment placed on said property by it.

8. Strikes, lockouts, Acts of God, and conditions over which the Company has no control shall severally be taken as sufficient excuse for any delay or interruption in the continuous prosecution of the drilling of said well by the Company, and any delay or interruption of drilling operations so caused shall not be deemed as a breach on the part of the Company of any of the covenants herein contained to be performed by it.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be executed the day and year first above written.

TWIN BELL OIL SYNDICATE
By W. B. ALLEN, President
[Seal] And THOS. H. LIPPS, Secretary.
W. M. KECK DRILLING COMPANY
By W. M. KECK, President
[Seal] And GEO. MACK, Secretary.

State of California
County of Los Angeles—ss.

ON THIS 11th day of May A. D., 1923, before me, Maude P. Greer, a Notary Public in and for the said County and State, residing therein, duly commissioned and sworn, personally appeared ..... Geo. Mack, ... known to me to be the Secretary of the W. M. Keck Drilling Company, the Corporation that executed the within Instrument, known to me to be the persons who executed the within Instrument, on behalf of the Corporation therein named, and acknowledged to me that such Corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] MAUDE P. GREER
Notary Public in and for said County and State.

[113]

State of California
County of Los Angeles—ss.

ON THIS 31st day of March, A.D., 1923 before me — Maude P. Greer, a Notary Public in and for the said County and State, residing therein, duly commissioned and sworn, personally appeared ..... W. M. KECK ..... Known to me to be the President of the W. M. KECK DRILLING COMPANY, the Corporation that executed the within Instrument, known to me to be the persons who executed the within Instrument, on behalf of the Corporation therein named, and acknowledged to me that such Corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

MAUDE P. GREER
Notary Public in and for said County and State.

[114]

EXHIBIT 9

COPY

THIS AGREEMENT, made and entered into this 12th day of January, 1923, by and between TWIN BELL OIL SYNDICATE, party of the first part, hereinafter called the Owner, and FEDERAL DRILLING COMPANY, a corporation organized and existing under and by virtue of the laws of the State of California, party of the second part, hereinafter called the Contractor:

WITNESSETH:

WHEREAS, the Owner is in possession of and

represents himself to be the Owner of an oil well on that certain real property leased by him, situate in the County of Los Angeles, State of California, on what is known as the Batson Lease, and more fully described as follows, to-wit:

Lots 2-3-4-5-6-7- and 8, Block 85, Santa Fe Springs Townsite.

AND WHEREAS, the Owner represents that said well has been drilled to a depth of 3509 feet and that a string of 3487 feet of 10 inch casing has been set and cemented therein, and

WHEREAS, the Owner desires to drill said well to a depth of approximately 4200 feet and set therein a string of 8¼ inch or 6¼ inch casing and cement the same in an endeavor to shut off water and thereafter, after the proper tests have been satisfactorily performed, to continue to drill said well to a depth of not more than 4700 feet and land therein a string of 6¼ inch or 4-¾ inch casing as an oil string and bring in said well in what is known as the Meyer sand.

WHEREAS, the Contractor is willing to furnish certain equipment and labor to perform said work upon the conditions hereinafter expressed;

NOW, THEREFORE, In consideration of the premises and of the covenants and conditions hereinafter expressed, on the part of the respective parties to be done and performed, it is hereby agreed:

[115]

1—The Contractor agrees to go upon the above described premises and to install in the derrick now

contained thereon, a rotary outfit and to furnish the necessary drill stem, tool joints, including the upkeep and repairs of said equipment, drilling labor and compensation insurance thereon and superintendence and supervision for the operations herein described, and shall furnish any and all casing, casing shoes and guides which may be used in said well. Upon the installation of said rotary outfit, the Contractor agrees to perform such services as may be required by the Owner with the limitation, however, that said services shall be confined to those acts necessary to drilling said well by the rotary method not to exceed a depth of 4700 feet, and bringing in the same in what is known as the Meyer sand, as hereinbefore described.

2—As compensation to the Contractor for services rendered in accordance with paragraph 1 above, the Owner agrees to pay to the Contractor the sum of Three Hundred Fifty Dollars ($350.00) per day, commencing with the day upon which the Contractor has placed its rotary outfit complete in the derrick, and ending with the day the same is removed from the premises of the Owner after notice from him that the services of the Contractor are no longer desired.

The Owner shall further pay to the Contractor an amount to equal the actual cost to Contractor of any and all casing, casing shoes and guides purchased by the Contractor for use in said well, also the cost to Contractor of the fitting and welding of same and cartage thereon.

The compensation herein agreed to be paid by the Owner to the Contractor shall be paid as follows to-wit:

> $5000.00 on the day the Contractor's rotary outfit is placed in the derrick, and fully rigged up.
>
> On or before the 5th and 20th day of each month during the progress of the work, $350.00 per day for each and every day during the period ending with the last day of the preceding month, and the 15th day of the current month respectively, after deducting from the first of said payments the [116] $5000.00 herein agreed to be paid on the day the Contractor's rotary outfit is placed in the derrick.

The cost of each string of casing, casing shoe and guide furnished hereunder, shall be repaid by the Owner to the Contractor on the day the same shall be delivered on the premises, and the cost of the fitting and welding and cartage thereof shall be repaid to the Contractor by the Owner at the time said work shall be performed. In the event the Contractor shall furnish any of the materials or services herein agreed to be furnished by the Owner, the cost of same shall be repaid to the Contractor by the Owner upon receipt by Owner of a statement thereof.

The Owner agrees to furnish all services and materials of every kind and nature whatsoever not herein specifically agreed to be furnished by the Contractor and including the necessary steam, water and

electricity for continuous operation, all cement required and the services of a cementing contractor.

It is understood and agreed that the Contractor shall have no liabilities for damages or personal injuries caused or arising from the operations herein contained, except that the Contractor hereby agrees to indemnify the Owner and save him harmless from all claims for damages resulting from injuries to any employee or employees of the Contractor. The Contractor agrees to discharge at once any and all liens which may be filed on the premises as the result of any failure on its part to meet obligations incurred by it and agrees to hold the Owner harmless from any such lien or liens.

The Contractor agrees to commence operations hereunder within fourteen days (14) after the execution of this agreement, and to proceed diligently with said work to completion, and upon the completion thereof as herein provided, the Contractor shall promptly remove from the premises of the Owner the equipment furnished by it and leave said premises and the materials furnished by [117] the Owner in as good a condition as they now are, reasonable wear and tear excepted.

This contract shall not be assigned, sub-let or transferred in whole or in part, except with the previous written consent of the Owner.

IN WITNESS WHEREOF, the Owner has executed these presents by signing the same and the Contractor by affixing its seal and by the signatures of its duly authorized officers in the day and year first

hereinabove written.

TWIN BELL OIL SYNDICATE

[Seal] By W. B. ALLEN, President

By THOS. H. LIPPS, Secretary

OWNER

FEDERAL DRILLING COMPANY

[Seal] By P. M. PIKE, President

By T. H. BEAMENT, Asst. Secretary

CONTRACTOR. [118]

EXHIBIT 11

TOTAL WELL COSTS OF PETITIONER

				Cumulative Total
Cost to December 31, 1922,				$256,632.00
Additions during		1923	$135,290.88	391,922.88
"	"	1924	—	391,922.88
"	"	1925	—	391,922.88
"	"	1926	—	391,922.88
Decrease	"	1927	3,543.78	388,379.10

[119]

JOINT EXHIBIT A-3.

SECOND AMENDED DECLARATION OF TRUST OF TWIN BELL OIL SYNDICATE

KNOW ALL MEN BY THESE PRESENTS:

That that certain Declaration of Trust dated on or about the 11th day of February, 1922 and duly recorded in the office of the County Recorder of Los Angeles County on the 20th day of March, 1922, in

Book 984, Page 270, official records of Los Angeles County, California, and the Amended Declaration of Trust, dated April 25th, 1922, duly recorded in the office of the County Recorder of Los Angeles County, on the 1st day of May, 1922, in Book 1049, Page 261, official records of Los Angeles County, California, are, in accordance with the powers vested in the Board of Trustees in said Declaration of Trust and Amended Declaration of Trust, amended to read as follows:

That the Trust Estate created herein shall be designated by the name and shall be known as

TWIN BELL OIL SYNDICATE

and that

WHEREAS, Thos. H. Lipps, of the County of Los Angeles, State of California, has heretofore sold, assigned, transferred and conveyed or is about to convey unto Elwood DeGarmo, Henry J. Grohs, James E. Mayberry, Thos. H. Lipps, Gilbert S. Sheets, L. E. H. DeSallier and Frank Martin, hereinafter designated as Trustees, and to the trustees succeeding them in interest for the purpose of this Trust, oil and gas leases on that parcel and piece of real property more particularly described as follows:

> Lots 2, 3, 4, 5, 6, 7 and 8 in the town of Santa Fe Springs, County of Los Angeles, State of California, as per map recorded in Book 26, page 37, et seq., Miscellaneous Records of Los Angeles County.

IT IS HEREBY UNDERSTOOD AND AGREED, that the said Trustees have accepted, received and will hold, such rights, title, interests and estates as have been assigned and conveyed to them [120] and by them acquired under the above mentioned assignment and conveyance in trust, nevertheless, for the uses and purposes set forth in this Declaration of Trust, to-wit:

TRUST CREATED:

FIRST: The said trustees, or their successors, shall hold all the funds and property of said trust estate now or hereafter coming into their possession, for the purposes, with the powers, and subject to the limitations herein declared; and it is hereby expressly declared that a trust and not a partnership or corporation is hereby created; and that the TWIN BELL OIL SYNDICATE is a trust and not a partnership or corporation.

The principal place of business and office of said trust estate, and of the trustees, shall be in the City of Los Angeles, State of California.

TRUST ESTATE AND PROPERTY:

SECOND: It is an express condition of this trust that the trust estate and property are, and shall be, only such rights, titles, estates and interests as said trustees may have received under said assignment and conveyance, or shall hereafter acquire subject to this trust, and the trustees are not, and shall not be responsible or assume any liability for the nature, value or extent of the title to any of the property herein described and accepted in trust

hereunder, nor for any adverse or conflicting claims or interests therein of any persons.

DUTIES OF TRUSTEES:

THIRD: During the term of this trust, said trustees, out of the moneys subject to this trust, whether principal or income therefrom, shall drill or cause to be drilled on the above described premises, a well, or wells, for oil to a depth of four thousand feet unless oil in paying quantity be found at a lesser depth; and pay, or cause to be paid from such moneys, the entire expense of drilling and equipping said well or wells, including all [121] rigging, casing, pipe and other material and all labor, fuel and water, and assume all responsibility and liability incident to said operation, subject to the limitations herein set forth. And when oil shall be found in paying quantity in the said well, or wells, such well or wells, will be completed and shut in with all necessary fittings and equipment and connected with pipe lines for marketing of oil therefrom; and from such moneys, subject to this trust, said trustees shall erect necessary derricks, buildings and other structures and produce necessary machinery and procure reasonable insurance upon all insurable property owned by them on the trust estate and shall pay or secure the payment of all liens, encumbrances, taxes, assessments or other charges against such property, properly chargeable to the trustees and necessary to protect their title to the trust estate, for the purpose of this trust; but in the event that said trustees shall not have such funds available and of sufficient amount to fully pay for such charges and expenses,

or any operations required of them herein, neither said trustees nor any unitholder shall be liable in any event, amount or degree, or to any person for any loss or damage suffered by reason thereof, to the trust estate or to any unitholder of this trust or to any person whomsoever.

POWERS OF TRUSTEES:

FOURTH: The trustees, in the name of the TWIN BELL OIL SYNDICATE, shall have full power, except as herein limited, to develop, operate, sell and deal in petroleum, oil properties and wells, and to buy, acquire, construct, maintain, operate pipe lines, and deal in machinery, implements, tools, conveniences of all kinds capable of being used in connection with oil, gas or other utilities. The execution of all contracts, of all conveyances and transfers and of all other instruments relative to the trust fund or any part thereof, by or pursuant to the authorization of a majority of the said trustees, or their successors, shall always be sufficient.

The trustees hereunder and their successors, shall have and [122] exercise the exclusive management and control of the trust estate; they may adopt and use a common seal; collect, sue for, receive and receipt for all sums of money at any time coming due to said trust; may employ counsel to begin procedure, defend or settle suits at law, in equity or otherwise, and to compromise or refer to arbitration, any claim in favor of or against the trust.

During the term of this trust and to enable them to properly execute the same according to the terms, provisions and intentions thereof, the trustees shall

have full power to hold or convey, grant, bargain, sell, lease for terms, to repair and make any improvements thereon or therein of such character, amount, costs and from such funds or property, subject to this trust as they may deem advisable, and to drill, operate for, develop and remove petroleum, oil naptha, natural gas, asphaltum or other kind substances in and from the real property described herein above, and generally in all respects to manage, handle develop and dispose of the whole or any part of the trust estate in conformity with the terms of this trust.

LIABILITY OF TRUSTEES AND UNIT-HOLDERS:

FIFTH: The Trustees shall have no power to bind the unitholders personally, otherwise than as hereinbefore provided and the unitholders and their assigns and all persons and corporations extending credit or contracting with or having a claim against the trustees shall look only to the funds or property of the trust for payment under such contract or claim, or for payment of any debt, damage, judgment or decree, or for any money that may otherwise become due or payable from them to the trustees, so that neither the trustees nor the unitholders, present or future, shall be personally liable therefor, and neither the trustees nor any of them shall ever be personally liable hereunder as partners, or otherwise; but for all debts the trustees shall be liable only to the extent of the trust funds or property held by them. In every written order, contract or obligation which the trustees shall give or enter into,

it [123] shall be the duty of the trustees to stipulate that neither the trustees nor the unitholders or their successors shall be held to any personal liability under or by reason of any order, contract or obligation.

The trustees shall not be liable for errors of judgment either in holding the property originally conveyed to them, nor for any act performed or omitted by them in the execution of this trust in good faith; nor shall they be liable for the acts or omissions of each other, or any officer, agent, or servant appointed or by acting for them; and they shall not be obligated to give any bond to secure the due performance of this trust by them. No assessment shall ever be made upon the unitholders or their assigns.

NUMBER OF TRUSTEES AND VACANCIES:

SIXTH: The number of trustees shall not be less than three (3), nor more than five (5), and any vacancy occasioned by the death or resignation or refusal to act of any trustee may be filled by the remaining trustees, and have the same powers, duties and liabilities as the original trustees hereunder. Upon resignation, decease, incapacity or removal, or vacancy for any cause, the title of the outgoing trustee or trustees, shall rest in the remaining trustees, and upon the filling of any vacancy by the remaining trustees, as aforesaid, the title of the whole trust shall rest in all the trustees whether appointed hereunder or by the remaining trustees to fill vacancies, as hereinbefore provided.

UNITS IN TRUST ESTATE:

SEVENTH: The trust estate consists of Three Thousand equal and undivided interests, which undivided interests are herein referred to as "units", of the nominal or par value of One Hundred ($100.00) Dollars each; and the owners of the undivided interests, or units, of the trust estate, and their assigns and grantees, are herein designated as "UNITHOLDERS". The units in said trust estate are undivided and indivisable and the holders and owners of the said units have no right of partition or segregation or dissolution [124] either in law or in equity; and the trust estate shall be managed and controlled as an entirety and for the benefit of all the unitholders according to the number of units held by each and as herein set forth.

In consideration of the sale, transfer, assignment and conveyance by the said Thos. H. Lipps, of the lease hereinbefore referred to, to the trustees hereunder, it is mutually agreed that the said Thos. H. Lipps shall be entitled to receive therefor Fifteen Hundred (1500) units of the par value of One Hundred ($100.00) Dollars each, and the said trustees have and do hereby agree to issue to the said Thos. H. Lipps, or his order, transferable certificates for the said Fifteen Hundred (1500) units in the said trust estate; and shall likewise pay, in the manner hereinafter provided, to-wit: after the cost of the well and drilling operations have been repaid to the unitholders, the sum of Seven Thousand and Five Hundred ($7500.00) Dollars out of the first

run of oil, as an additional bonus for the transfer of the lease to the Syndicate.

SALE OF UNITS AND CERTIFICATES:

EIGHTH: In addition to the said 1500 units to be issued to the said Thos. H. Lipps, in consideration for the transfer, sale, assignment and conveyance of the leases hereinbefore referred to, the trustees shall issue and sell, at public or private sale, upon such terms and for such prices as they may deem expedient, such additional units as may be necessary to provide means for the prosecution and furtherance of the objects of this trust and to defray the costs and expense thereof, subject, however, to the approval of the Commissioner of Corporations or other proper offices of the State of California.

In the case of a loss or destruction of any certificates for units issued by the trustees, the trustees may, under such conditions as they may deem expedient, issue a new certificate or certificates in the place of one lost or destroyed. [125]

As evidence of the ownership of said units, the trustees shall cause to be issued to each unitholder, a transferable certificate or certificates, which certificates shall be in the form following, to-wit:

Number: Units:

TWIN BELL OIL SYNDICATE

Los Angeles, California

Capital $300,000.00

This Is To Certify That.....is the owner of.....units fully paid and non-assessable

of the par value of One Hundred ($100.00) Dollars each, of the beneficial interest in the TWIN BELL OIL SYNDICATE, a business trust, transferable only on the books of the company by the owner thereof in person or by duly authorized attorney upon surrender of this certificate properly endorsed.

This certificate is held subject to an agreement and Declaration of Trust dated February 11th, 1922, and also subject to an Amended Declaration of Trust executed on or about the 25th day of April, 1922, and also subject to a Second Amended Declaration of Trust, dated March 14th, 1925; said Declaration of Trust and said Amended Declaration of Trust and said Second Amended Declaration of Trust thereto being duly recorded in the office of the County Recorder of Los Angeles County, all of which are hereby referred to and made a part of this certificate.

Said Declaration of Trust provides:

That no unitholder shall ever be personally liable for any debt, covenants, demands, contracts or torts of any kind of the company.

WITNESS the signatures of the trustees of said company this.....day of.....A. D., 19.....

TWIN BELL OIL SYNDICATE

By.....

President of the Board

Attest:

.....

Secretary of the Board.

DIVIDENDS:

NINTH: The trustees shall declare dividends quarterly out of the net earnings or profits of trust, which said dividends shall dispose of all the net earnings or profits less the actual maximum cost of maintenance and operation. It is understood, however, that before any dividends shall be divided generally amongst all unitholders of record, there shall first be paid out of the [126] first run of oil, to the unitholders and investors who have purchased the fifteen hundred units from the proceeds of which the well has been drilled, the full amount of their investment, and thereafter in addition thereto, a bonus to Thos. H. Lipps in the sum of Seven Thousand Five Hundred ($7500.00) Dollars, with interest at the rate of eight per cent (8%) per annum from Feb. 9, 1922, and that only after such unit holders have been repaid for said investment by them, and the said bonus to Thos. H. Lipps shall have been paid, shall dividends be declared generally amongst all the unitholders of record; the specific intent of this paragraph being to repay to investors the amount of cash which each has invested for the purpose of drilling the aforesaid well, as well as to repay the bonus provided, before the profits shall be divided generally amongst all unitholders interested in the Syndicate.

MEETINGS OF TRUSTEES AND BY-LAWS:

TENTH: Meetings of the Trustees shall be held from time to time upon the call of the President or any three of the Trustees. A majority of the trustees

shall constitute a quorum, but in no event shall any meeting of said trustees be held, nor any business transacted be binding upon this trust, unless and until all of the trustees herein named shall first have received written notice of said meeting; the concurrence of all the trustees shall not be necessary to the validity of any action taken by them, but the wish of a majority of the trustees present and voting at any meeting shall be conclusive unless in this Declaration of Trust specifically provided otherwise. The trustees may make, adopt, amend or repeal such bylaws, rules and regulations, not inconsistent with the terms of this instrument, as they may deem necessary or desirable for the conduct of their business and for the government of themselves and their agents, servants or representatives.

OFFICERS:

ELEVENTH: The trustees shall annually elect from among [127] their number a President and vice-President, and shall also annually elect a treasurer and secretary, and they shall have authority to appoint such other officers, agents and attorneys as they may from time to time deem necessary or expedient for the conduct of their business and upon such terms as they may deem necessary or advisable. They shall have authority to remove any and all officers, agents and employees at their pleasure; to accept resignations and to fill any vacancy occurring in the office of President, Vice-President, Treasurer or Secretary, for the unexpired term, and shall likewise have authority to elect temporary officers to serve during the absence or disability of the regular offi-

cers. The President, Vice-President, Treasurer and Secretary shall have such authority and perform such duties as may from time to time be determined by the trustees and only such salaries or compensation shall be paid to such officers or trustees as may be agreed upon by unanimous consent of all the trustees, and no change in such salaries shall be made unless by unanimous consent of the Board of Trustees.

MEETINGS:

TWELFTH: The trustees may call meetings of the unitholders annually on the first Tuesday of March and shall prepare and submit to unitholders at such meeting a full report of all their operations, including moneys raised and disbursed for the year ending on the 31st day of December preceding. Special meetings of the unitholders may be called by the trustees at their pleasure by giving the notice hereinafter provided for.

NOTICE OF MEETINGS:

THIRTEENTH: Notice of annual and special meetings shall be deemed binding upon each of the unitholders if mailed, prepaid to the last address given by him, to the trustees, or in default thereof. to his last business place or abode. Notice of meetings shall be given five days beforehand and may be given by advertisement for three (3) successive days in a paper of general circulation published in the City of Los Angeles, County of Los Angeles, [128] State of California, the last publication to be at least five (5) days before the date of the meeting, or may be mailed, at the option of the trustees.

In notices of special meetings, the purpose thereof shall be stated.

VOTING:

FOURTEENTH: The trustees shall keep a book for recording therein the names and addresses of unitholders and of the sales and transfers of units. No sale or transfer of any unit in said trust estate shall be valid or binding on said trustees, until same shall be transferred on the books of the Syndicate, and in all cases of transfer of units, the trustees may require proof satisfactory to themselves of the title of the claimant as owner of the units.

EFFECT OF DEATH OF TRUSTEES OR UNITHOLDERS:

FIFTEENTH: The death of a unitholder or trustee during the continuance of this trust shall not operate to terminate the trust, nor shall it entitle the legal representative of the deceased unitholder to an accounting or to take any action in the courts or elsewhere, against the trustees, but the executors, administrators, or assigns of said decedent under this trust upon surrender of the certificate or certificates, for the units owned by him, shall succeed to the rights of said decedent.

AMENDMENT OF DECLARATION:

SIXTEENTH: The trustees may by unanimous consent alter or amend this Declaration of Trust.

DURATION OF TRUST:

SEVENTEENTH: This trust shall endure and continue until the expiration of fifty (50) years from the date hereof and may then or at any time prior

thereto be terminated by unanimous consent of the trustees. But the trustees shall not be required to give bond and each shall be liable only for his own acts and then only for wilful breach of trust. Upon termination of the trust hereby created, the trustees shall liquidate the trust estate and divide the remain- [129] ing assets among the unitholders in proportion to their respective interests, or shall convey the whole of the trust estate subject to all then existing assessments, encumbrances, or other matters affecting title to the unitholders therein entitled to take the same under the terms hereof; provided, however, that first all the charges and expenses therein due the trustees hereunder shall be fully paid and said trustees shall be fully relieved and discharged from all then existing and future obligations and liabilities.

SEVENTEENTH-A: And any resolution, minute or motion that may be passed by unanimous vote of the Board of Trustees which may be deemed to contravene any of the terms of this Declaration of Trust and any instrument, deed, covenant, covenants or instruments of any kind or character that may be executed by unanimous vote of the Board of Trustees which may be deemed or appear in contravention of the terms of this trust shall be deemed to supersede the provisions of this trust with the same force and effect as though the same had been made a part of the original Declaration of Trust and a part of the Amended Declaration of Trust, the intent of this paragraph being to permit the Trustees by unanimous vote to make such changes from time to time in the Declaration of Trust and the various Amended

Declarations of Trust as the conditions of the trust estate may be to them deemed advisable without the necessity of executing any additional instruments or documents.

EIGHTEENTH: None of the powers in this Declaration of Trust set out shall be construed as authorizing the trustees, (without first obtaining the unanimous consent of the entire Board) to acquire any properties or oil leases, or to dispose of the whole or any part of the capital or assets or other properties of this trust either in whole or in part, it being the specific intention of this paragraph to limit the powers and duties of the trustees to the management and control of the property owned and controlled by the Syndicate, including the proceeds to be derived from the discovery [130] and development of oil on the premises owned or controlled by the Syndicate, and to compel the said trustees to make quarterly distribution of the entire net proceeds amongst unitholders as in Paragraph Nine (9) of this Declaration of Trust set forth.

Nor shall any act be done directly or indirectly in contravention of this paragraph unless the unanimous consent of the entire Board, at a regular meeting, duly called for that purpose, shall first be had and obtained.

In all other respects the aforesaid Amended Declaration of Trust is hereby declared to remain unchanged and in full force and effect as though the Amendments and alterations hereby made had been therein originally incorporated, and

WE, THE UNDERSIGNED, do hereby certify

that we do collectively constitute the entire Board of Trustees of the aforesaid trust, that all units or certificates of beneficial interest heretofore sold were sold subject to the conditions contained in the original Declaration of Trust, dated February 11, 1922, and the Amended Declaration of Trust dated April 25, 1922, and that this Declaration of Trust is made pursuant to the power vested in the Trustees by Paragraph Sixteen (16) of the Amended Declaration of Trust, duly recorded in the office of the County Recorder, as hereinbefore set forth.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and affixed their seals this 14th day of March, 1925.

THOS. H. LIPPS
W. B. ALLEN
P. H. GREER
HENRY J. GROHS [131]

State of California
County of Los Angeles—ss.

On this 6th day of April, 1925, before me, Saul Ruskin, a Notary Public in and for said County and State, residing therein, duly commissioned and sworn, personally appeared W. B. Allen, Henry J. Grohs, P. H. Greer and Thos. H. Lipps, known to me to be the persons whose names are subscribed to the within instrument, and acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year

in this certificate first above written.

[Seal] SAUL RUSKIN

Notary Public in and for said County and State.

[Endorsed]: United States Board of Tax Appeals. Filed Oct. 20, 1930. [132]

[Title of Court and Cause.]

PRAECIPE

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies, duly certified as correct, of the following documents and records in the above entitled proceeding in connection with the petition for review by the said United States Circuit Court of Appeals for the Ninth Circuit heretofore filed by the petitioner on review:

1. Docket entries.
2. Pleadings before the Board.
   (a) Petition with exhibits attached thereto.
   (b) Commissioner's answer to petition.
3. Findings of fact, opinion and decision of the Board, including final order of redetermination.
4. Petition for Review and assignments of error.
   (a) Notice of filing thereof, with admission of service.
5. This praecipe. [133]

6. Statement of Evidence with exhibits attached.

CLAUDE I. PARKER
JOHN B. MILLIKEN
GEORGE H. KOSTER
LLEWELLYN A. LUCE
Attorneys for Petitioner on Review

No objection to this praecipe.

C. M. CHAREST
General Counsel
Bureau of Internal Revenue.

[Endorsed]: United States Board of Tax Appeals. Filed May 16, 1933. [134]

[Title of Court and Cause.]

CERTIFICATE

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 134, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 7th day of June, 1933.

[Seal] B. D. GAMBLE
Clerk, United States Board of Tax Appeals.

No. 7190

United States

Circuit Court of Appeals

For the Ninth Circuit.

GUY T. HELVERING, as Commissioner of Internal Revenue,

Petitioner,

vs.

TWIN BELL OIL SYNDICATE,

Respondent.

Transcript of the Record

Upon Petition to Review an Order of the United States Board of Tax Appeals.

United States Board of Tax Appeals

Doc. No. 45052

TWIN BELL OIL SYNDICATE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

NOTICE OF FINAL SETTLEMENT.

The enclosed determination will be presented to the United States Board of Tax Appeals for settlement on

This notice of proposed determination is submitted in accordance with the decision of the Board without prejudice to the Commissioner's right to contest the correctness of the decision pursuant to the statute in such cases made and provided.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

ARTHUR CARNDUFF,
Special Attorney,
Bureau of Internal Revenue.

AC/mhk 7/6/32

[Endorsed]: United States Board of Tax Appeals. Filed Jul. 9, 1932. [20]

STATEMENT

IT:AN:E-7
WJW

In re: Twin Bell Oil Syndicate,
Los Angeles, California.
Tax Liability

Years	Tax Liability	Tax Assessed	Deficiency
~~1922~~	~~None~~	~~None~~	~~None~~
~~1923~~	~~None~~	~~None~~	~~None~~
1925	$52,835.31	None	$52,835.31
1926	54,563.99	$45,369.36	9,194.63
1927	16,113.07	13,481.47	2,631.60
	$123,512.37	$58,850.83	$64,661.54

[21]

Twin Bell Oil
Syndicate — Year ended December 31, 1925

SCHEDULE 1

Net Income

Net income as disclosed by 60 day letter May 3, 1929	$417,597.51
As corrected	406,425.47
Net adjustment	$ 11,172.04

Additional depreciation allowable under decision of the United States Board of Tax Appeals, docket No. 45052, promulgated May 25, 1932.

SCHEDULE 2
Computation of Tax
Income Tax

Net income for taxable year (Schedule 1)	$406,425.47
Income tax at 13%	$ 52,835.31
Tax previously assessed	None
Deficiency	$ 52,835.31

Year ended December 31, 1926

SCHEDULE 3
Net Income

Net income as disclosed by 60 day letter May 3, 1929	$413,130.72
As corrected	404,177.68
Net adjustment	$ 8,953.04

Additional depreciation allowable under decision of the United States Board of Tax Appeals, docket No. 45052, promulgated May 25, 1932. [22]

Twin Bell Oil Syndicate

Year ended December 31, 1926

SCHEDULE 4
Computation of Tax
Income Tax

Net income for taxable year (Schedule 3)	$404,177.68
Income tax at 13½%	$ 54,563.99
Tax previously assessed	45,369.36
Deficiency	$ 9,194.63

Year ended December 31, 1927

SCHEDULE 5

Net Income

Net income as disclosed by 60 day letter May 3, 1929	$127,720.50
As corrected	119,366.10
Net adjustment	$ 8,364.40

Additional depreciation allowable under decision of the United States Board of Tax Appeals docket No. 45052 promulgated May 25, 1933.

SCHEDULE 6

Computation of Tax

Net income for taxable year	$119,366.10
Income tax at 13½%	$16,113.07
Tax previously assessed	13,481.47
Deficiency	$ 2,631.60

[23]

In the United States Circuit Court of Appeals for the Ninth Circuit.

B. T. A. Docket No. 45052

DAVID BURNET, Commissioner of Internal Revenue, Petitioner,

v.

TWIN BELL OIL SYNDICATE, Respondent.

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

NOW COMES David Burnet, Commissioner of Internal Revenue, by his attorneys, G. A. Youngquist, Assistant Attorney General, and C. M. Charest, General Counsel, Bureau of Internal Revenue, and Arthur Carnduff, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

That the petitioner on review is the duly appointed qualified and acting Commissioner of Internal Revenue of the United States, appointed and holding his office by virtue of the laws of the United States; that the respondent on review is an association, organized under the laws of the State of California, and with principal office at 1018 C. C. Chapman Building, in the City of Los Angeles and State of California; that the respondent filed its income tax returns for the years 1925, 1926 and 1927

in the office of the Collector of Internal Revenue for the Sixth Collection District of California, which is within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit.

II.

This is a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of a decision of the United States Board of Tax Appeals entered on September 3, 1932, determining that there are [25] deficiencies in income taxes due from the respondent in the amounts of $52,835.31 for the calendar year 1925, $9,194.63 for the calendar year 1926, and $2,631.60 for the calendar year 1927.

III.

That on May 3, 1929, the Commissioner of Internal Revenue, pursuant to the provisions of Section 274 of the Revenue Act of 1926 determined deficiencies in income taxes against the respondent in the amounts of $54,287.68 for the calendar year 1925, $10,403.29 for the calendar year 1926, and $3,760.80 for the calendar year 1927 and on said date mailed to the respondent notice of said deficiencies; that thereafter on July 1, 1929 the respondent filed a petition with the United States Board of Tax Appeals, pursuant to the provisions of said Section 274 of the Revenue Act of 1926 and Section 272 of the Revenue Act of 1928, seeking a redetermination of said deficiencies.

The proceeding was heard by the United States Board of Tax Appeals on October 20, 1930, upon a stipulation of facts and evidence introduced on

behalf of the respondent herein. The findings of fact and opinion of the United States Board of Tax Appeals were promulgated May 25, 1932 and the order of redetermination determining that there were deficiencies of $52,835.31, $9,194.63 and $2,631.60 for the calendar years 1925, 1926 and 1927, respectively, was entered on September 3, 1932.

IV.

The nature of the controversy is as follosw:

The question upon which the petitioner seeks review by the court is whether the respondent is entitled to recover intangible expenses such as labor, wages, fuel, etc. in connection with the exploration, development [26] and drilling of oil wells through annual deductions for depletion as determined by the petitioner or through annual deductions for depreciation, as decided by the Board of Tax Appeals.

In 1922 respondent owned a lease on oil lands. In 1922 two wells were drilled on respondent's property for a fixed sum. Costs of labor and material were not segregated. The two wells were deepened in 1923. The amounts paid to the contractors for drilling the wells include the total cost of the wells, and nowhere on respondent's books was any segregation made for the portion of the cost which represented materials going into the wells and the portion which represented labor and fuel incident to drilling.

The petitioner in his determination of deficiencies in income taxes for the years in controversy allocated 40% of the total cost of the wells to tan-

gible equipment cost and allowed depreciation on the same. He determined that 60% of the total cost of the wells represented intangible drilling costs, such as labor, wages, fuel, etc. and added such 60% of the well costs to the lease account returnable through depletion. The petitioner in his determination of the income tax liabilities here in question denied the respondent the right to charge or be allowed deductions for depreciation with respect to such 60% of the well costs, but did allow depletion upon the same and did allow depreciation upon the remaining 40% of such costs.

At the hearing before the Board the parties stipulated and agreed that if the respondent were not entitled to deduct from its income for the taxable years in controversy, depreciation computed upon the total well cost, then the determination of the respondent was correct, that is, an allocation of 60% of the cost to intangibles and 40% of the cost to tangibles was correct, provided respondent was not entitled to compute and deduct depreciation on the [27] total costs.

The wells were drilled under what is known as a "turnkey" contract, that is, for a lump sum, payable to the contractor who drilled them, for the completed wells.

The Board of Tax Appeals held that the total cost of the wells represented an investment in an improvement, which is subject to depreciation and that the respondent was entitled to compute and deduct depreciation upon the total cost of the wells, and that the petitioner erred in allowing deduction

for depreciation in respect of only 40% of said costs, which 40% represented tangible equipment costs, and that the petitioner erred in denying depreciation deductions upon the other 60% of said costs, which 60% represented intangible drilling costs, such as labor, wages, fuel, etc., although the petitioner allowed depletion deductions upon said 60%. The Board of Tax Appeals reduced the income tax liability of the respondent for each of the years in controversy, accordingly.

The petitioner believes that the total cost of said wells is not subject to depreciation and that the Board of Tax Appeals erred in its opinion and erred in its decision reducing the income tax liability of the respondent for the years 1925, 1926 and 1927. The Commissioner of Internal Revenue believes that only such part of the cost of the wells as was expended for tangibles, such as derricks, machinery and pipe, is subject to depreciation and that such part of the cost of the wells as was expended for tangibles such as derricks, machinery and pipe is subject to depreciation and that such part of the cost of the wells as was expended for labor, wages, fuel and intangibles was not subject to depreciation but was capital expenditures subject to depletion. [28]

V.

WHEREFORE, in view of said opinion and decision by the United States Board of Tax Appeals, review thereof in the United States Circuit Court of Appeals for the Ninth Circuit is sought herein.

The errors committed by the United States Board of Tax Appeals which are relied upon as a basis of this proceeding are as follows:

1. The Board erred as a matter of law in holding that the total cost of the wells was subject to depreciation.

2. The Board erred as a matter of law in holding that the total cost of the wells was subject to depreciation, when the parties had stipulated and agreed that 60% of said cost had been expended for intangible drilling costs, such as labor, wages, fuel, etc.

3. The Board erred as a matter of law in holding that respondent might compute depreciation upon the 60% of such costs which had been expended for intangibles, such as labor, wages, fuel, etc. and deduct such depreciation from its taxable income for the taxable years in controversy.

4. The Board erred in holding that the intangible cost of the wells, including labor, wages, fuel, etc. is recoverable for income tax purposes by annual deductions for depreciation instead of annual deductions for depletion and in failing to hold that said intangible cost is returnable for income tax purposes through annual deductions for depletion.

5. The Board erred in finding that the income tax liability of the respondent for the years 1925, 1926 and 1927 was less than the liability determined by the Commissioner of Internal Revenue.

6. The Board erred in reducing the income tax liability of the respondent for the taxable years in controversy as determined by the Commissioner of Internal Revenue by reducing the taxable net income of the [29] respondent for said years, by allowing a deduction for depreciation in each of

said years, greater than the depreciation allowed by the Commissioner of Internal Revenue in his determination.

7. The Board erred in failing to find that there were deficiencies in income taxes due from the respondent in the amounts of $54,287.68 for the calendar year 1925, and $10,403.29 for the calendar year 1926, and $3,760.80 for the calendar year 1927, as determined by the respondent.

8. The Board erred in failing to sustain the determination of the Commissioner of Internal Revenue.

WHEREFORE, the petitioner, the Commissioner of Internal Revenue, petitions that said opinion and decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and rules of the said court to be transmitted to the clerk of said court for filing; and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected by said court.

G. A. YOUNGQUIST,
Assistant Attorney General.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

ARTHUR CARNDUFF,
Special Attorney,
Bureau of Internal Revenue. [30]

United States of America,
District of Columbia.—ss.

C. M. Charest, being first duly sworn, says that he is General Counsel for the Bureau of Internal Revenue, and as such is duly authorized to verify the above and foregoing petition for review; and that he is familiar with the statements therein contained and that the same are true to the best of his knowledge, information and belief.

(Signed) C. M. CHAREST.

Subscribed and sworn to before me this 29th day of November, 1932.

[Seal] (Signed) MARCELLETTE M. TAYLOR,
Notary Public, District of Columbia.

My commission expires March 31, 1935.

[Endorsed]: United States Board of Tax Appeals. Filed Nov. 29, 1932. [31]

[Title of Court and Cause.]

NOTICE OF FILING PETITION ON REVIEW

To: John B. Milliken, Esq., George H. Koster, Esq., Claude I. Parker, Esq., 808 Bank of America Building, Los Angeles, California, Attorneys for Twin Bell Oil Syndicate, Respondent on Review, and Twin Bell Oil Syndicate, 1018 C. C. Chapman Building, Los Angeles, California, Respondent on Review:

You are hereby notified that the Commissioner of Internal Revenue did, on the 29th day of No-

vember, 1932, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 29th day of November, 1932.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 2nd day of December, 1932.

TWIN BELL OIL SYNDICATE
By Thos. W. Sipes
Respondent on Review
CLAUDE I. PARKER
JOHN B. MILLIKEN
By Geo. H. Koster
Attorney for Respondent on Review.

[Endorsed]: United States Board of Tax Appeals. Filed Dec. 12, 1932. [32]

United States Board of Tax Appeals

Docket No. 45052.

DAVID BURNET, Commissioner of Internal Revenue,

Petitioner on Review,

vs.

TWIN BELL OIL SYNDICATE,

Respondent on Review.

STATEMENT OF EVIDENCE

It is hereby stipulated and agreed by and between the respective parties hereto, by and through their respective counsel of record, that the following facts as found by the Board are true and correct and sustained by the evidence presented at the hearing of this cause before the Board of Tax Appeals, at Los Angeles, California, October 20, 1930, Honorable Annabel Matthews, Member, presiding.

The two wells drilled on petitioner's property in 1922 were drilled under contracts with the Keck Drilling Corporation for a fixed sum. Costs of labor and materials were not segregated. The two wells drilled in 1922 were deepened in 1923, also under contracts. The total well costs of petitioner under the contracts were as follows:

		Cumulative Total
Cost to December 31, 1922,		$256,632.00
Additions during 1923 —	$135,290.88	391,922.88
" " 1924	—	391,922.08
" " 1925	—	391,922.88
" " 1926	—	391,922.88
Decrease " 1927	3,543.78	388,379.10 [33]

The amounts paid to the contractors under the contracts were charged on petitioner's books as "Well Cost, No. 1 Well", and "Well Cost, No. 2 Well". The amounts paid to the contractors for drilling the wells includes the total cost of the wells and nowhere on petitioner's books was any segregation made for the portion of the cost which represented materials going into the wells and the portion which represented labor and fuel incident to the drilling.

The respondent, in the determination of the deficiencies here in question, allocated 40 per cent of the total cost of the wells to tangible equipment cost and allowed depreciation on the same. He determined that 60 per cent of the cost of the wells represented intangible drilling costs, such as labor, wages, fuel, etc., and added such 60 per cent of the well costs to the lease account returnable to the petitioner through depletion. Respondent denied the petitioner the right to charge or be allowed depreciation deductions with respect to 60 per cent of the well costs.

The parties have stipulated and agreed that if the Board should determine that the petitioner is not entitled to depreciation on the total well cost, then

the determination of the respondent is correct. But if the Board should determine that the petitioner is entitled to charge the total well cost to its well account and be allowed depreciation on the same, it is stipulated that petitioner is entitled to an additional depreciation deduction for the several years as follows:

1925	$11,172.04	
1926	8,953.04	
1927	8,364.40	[34]

The foregoing facts are the material facts in respect of the above-entitled petition for review filed by the ommissioner of Internal Revenue.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue,
Attorney for Petitioner on Review.
(Sgd.) CLAUDE I. PARKER
(Sgd.) JOHN B. MILLIKEN
(Sgd.) GEORGE H. KOSTER
(Sgd.) LLEWELLYN A. LUCE
Attorneys for Respondent on Review.

ACf/mhk 5/3/33

The foregoing statement of evidence is hereby approved and ordered filed.

(S.) ANNABEL MATTHEWS,
Member, United States Board of Tax Appeals.

[Endorsed]: United States Board of Tax Appeals. Filed May 15, 1933. [35]

[Title of Court and Cause.]

PRAECIPE FOR RECORD.

To the Clerk of the United States Board of Tax Appeals:

Please prepare and transmit and deliver forthwith, to the Clerk of the United States Circuit Court for the Ninth Circuit, duly certified copies of the following documents in the above-entitled cause:

1. The docket entries before the Board.
2. The pleadings before the Board including the petition and answer.
3. The findings of fact, opinion, decision and judgment of the Board.
4. The respondent's recomputation of tax liability filed under Rule 50 of the Board, pursuant to the Board's opinion.
5. The petition for review filed by the respondent.
6. The notice of filing of the petition for review.
7. The acknowledgment of service of said notice.
8. The statement of evidence filed on behalf of the respondent by stipulation of the parties, including the findings of fact made a part thereof.
9. This praecipe. [36]

The foregoing to be prepared, certified, transmitted and delivered as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue,
Attorney for Petitioner on Review.

Service of a copy of the within praecipe is hereby admitted this 10th day of May, 1933. No objection to this praecipe.

(Sgd) CLAUDE I. PARKER,
(Sgd) JOHN B. MILLIKEN,
(Sgd) GEORGE H. KOSTER,
(Sgd) LLEWELLYN A. LUCE,
Attorneys for Respondent on Review.

[Endorsed]: United States Board of Tax Appeals. Filed May 15, 1933. [37].

[Title of Court and Cause.]

CERTIFICATE.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 37, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 7th day of June, 1933.

[Seal] B. D. GAMBLE,
Clerk,
United States Board of Tax Appeals.

[Endorsed]: No. 7190. United States Circuit Court of Appeals for the Ninth Circuit. Twin Bell Oil Syndicate, Petitioner, vs. Guy T. Helvering, as Commissioner of Internal Revenue, Respondent and Guy T. Helvering, as Commissioner of Internal Revenue, Petitioner, vs. Twin Bell Oil Syndicate, Respondent. Transcript of the Record. Upon Petitions to Review an Order of the United States Board of Tax Appeals.

Filed June 14, 1933.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 7190

TWIN BELL OIL SYNDICATE, PETITIONER

v.

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

TWIN BELL OIL SYNDICATE, RESPONDENT

Upon petitions to review an order of the United States Board of Tax Appeals

Proceedings had in the United States Circuit Court of Appeals for the Ninth Circuit

At a stated term, to wit: The October term, A.D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the court room thereof, in the city and county of San Francisco, in the State of California, on Monday, the twenty-fourth day of July, in the year of our Lord one thousand nine hundred and thirty-four.

Present: Honorable William H. Sawtelle, circuit judge, presiding; Honorable Frank H. Norcross, district judge.

In the matter of the substitution of Guy T. Helvering, as Commissioner of Internal Revenue, in the place of David Burnet

Upon consideration of motion of petitioner or petitioners, consented to by respondent or respondents, in each of the following causes, it is ordered that Guy T. Helvering, as Commissioner of Internal Revenue, be, and he hereby is, substituted for David Burnet, former Commissioner of Internal Revenue, in each of the following causes, and that each of the following causes be so continued and maintained:

* * * * * * *

Twin Bell Oil Syndicate v. *Comm'r of Int. Revenue*, and *Commissioner of Int. Revenue* v. *Twin Bell Oil Syndicate.*

* * * * * * *

At a stated term, to wit: The October term, A.D. 1933, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the court room thereof, in the city and county of San Francisco, in the State of California, on Tuesday, the twelfth day of December, in the year of our Lord one thousand nine hundred and thirty-three.

Present: Honorable Curtis D. Wilbur, senior circuit judge, presiding; Honorable William H. Sawtelle, circuit judge; Honorable Francis A. Garrecht, circuit judge.

No. 7190

Order of submission

Ordered petitions to review in above cause argued by Mr. George H. Koster, counsel for Twin Bell Oil Syndicate, and by Mr. Francis H. Horan, special assistant to the Attorney General, counsel for Commissioner of Internal Revenue, and submitted to the court for consideration and decision.

At a stated term, to wit: The October term, A.D. 1933, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the court room thereof, in the city and county of San Francisco, in the State of California, on Thursday, the twelfth day of April, in the year of our Lord one thousand nine hundred and thirty-four.

Present: Honorable Curtis D. Wilbur, senior circuit judge, presiding; Honorable William H. Sawtelle, circuit judge; Honorable Francis A. Garrecht, circuit judge.

No. 7190

Order directing filing of opinion and filing and recording of judgment

By direction of the court, ordered that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion filed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 7190. April 12, 1934

TWIN BELL OIL SYNDICATE, PETITIONER

v.

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

TWIN BELL OIL SYNDICATE, RESPONDENT

Upon petitions to review an order of the United States Board of Tax Appeals

Before: Wilbur, Sawtelle and Garrecht, circuit judges

SAWTELLE, *Circuit Judge:*

Petitions for review from a decision of the Board of Tax Appeals have been brought to this court by both the taxpayer and the Commissioner. The Board held that there were income tax deficiencies for the years 1925, 1926, and 1927 in the amounts of $52,835.31, $9,194.63 and $2,631.60, respectively, 26 B.T.A. 172.

On May 3, 1929, the Commissioner notified the taxpayer that he had determined deficiencies in the latter's income tax for the years 1925, 1926, and 1927 in an aggregate amount of $68,451.77. From this determination the taxpayer appealed to the Board, which on May 25, 1932, promulgated its findings of fact and opinion, and on September 3, 1932, entered its decision. By agreement between the parties, the record in both petitions for review was consolidated in one transcript.

The taxpayer was organized under a declaration of trust executed on February 11, 1922, to take over the lease to certain oil properties for the purpose of developing them, to secure the proceeds from the disposition of any oil and gas produced therefrom, and to distribute the proceeds to the beneficiaries.

Under the declaration of trust, the trustees took title to the lease through an assignment to them from Thomas H. Lipps. The original declaration of trust of February 11, 1922, was amended on April 25, 1922, and subsequently a second amended declaration of trust was executed on March 14, 1925.

The amendment of March 14, 1925, made the following changes: The minimum number of trustees was made three, and the maximum five. Such salaries or compensation to the officers or trustees as might be agreed upon by unanimous consent of all the trustees, were authorized. In 1925 and thereafter, the trustees, voted themselves salaries. Paragraph 12 was amended by substituting "may" for "shall", so that the first sentence thereof reads: "The trustees may call meetings of the unit holders annually * * *." A paragraph designated seventeen-A was added, which allowed the trustees to amend the trust by any resolution, minute or motion passed by unanimous vote of all the trustees, without further formality, "the intent of this paragraph being to permit the trustees by unanimous vote to make such changes from time to time in the declaration of trust and the various amended declarations of trust as the conditions of the trust estate may be to [sic] them deemed advisable without the necessity of executing any additional instruments or documents." Paragraph 18 was so amended as to permit in effect the purchase of additional property and sales by the trustees, but such acts could be done only by unanimous consent of all of the trustees at a meeting called for that purpose.

The essential characteristics of the organization as it existed under the three declarations of trust were not materially different, insofar as they affected the nature of the syndicate for the purpose of income tax. The purpose of the amended declaration of April 25, 1922, however, was to strengthen the trust provisions that the trustees should have exclusive management and control of the trust property. It is not necessary for us to detail those provisions, since the Commissioner concedes in his brief that "The trustees kept the books, negotiated all contracts, and were never subject to the supervision or control of the unit holders."

Certificates of beneficial interest, which were transferrable on the books of the trust, were issued to persons who, by the contribution of a price of at least $100 for each unit, became beneficiaries or unitholders under the trust. All the certificates bore the stamp that they were subject to the provisions of the declarations of trust dated February 11, 1922, April 25, 1922, and—as to certificates issued after the second amended declaration of trust—March 14, 1925. No units were issued prior to April 25, 1922.

As amended on April 25, 1922, the trust instrument empowered the trustees to drill wells, develop them, deal in petroleum, and "hold or convey, grant, bargain, sell, lease for terms, repair and make any improvements thereon * * * subject to this trust as they may deem advisable." They might use a common seal. Neither trustees nor unitholders were to be held personally liable for debts of the trust, and creditors were to "look only to the funds or property of the trust for payment." No assessment should ever be made upon the unitholders. Any vacancy among the trustees was to be filled by those remaining. The trustees could declare quarterly

"dividends." Meetings of the trustees were to be held on the call of the president or of any three of the trustees. The death of a unit-holder or trustee should not operate to terminate the trust, but his executors or other representatives were to succeed to his rights. The trustees might by unanimous consent amend or alter the declaration of trust. The trust was to run for 50 years, and might then or at any time prior thereto be terminated by unanimous consent of the trustees.

Paragraph 18 of the declaration of trust provided:

"None of the powers in this declaration of trust set out shall be construed as authorizing the trustees to acquire any properties or oil leases, or to dispose of the whole or any part of the capital or assets or other properties of this trust either in whole or in part, it being the specific intention of this paragraph to limit the powers of the trustees to the management and control of the property now owned, and controlled by the syndicate, including the proceeds to be derived from the discovery and development of oil on the premises owned or controlled by the syndicate, and to compel the trustees to make quarterly distribution of the entire net proceeds amongst unit holders of record as in paragraph ninth of this declaration set forth."

The certificates referred to the syndicate as a "company", and were to be signed by the "president of the board."

All three declarations of trust contained specific provisions for the annual election of officers by the trustees from among their own number. The officers were president, vice president, treasurer, and secretary, and all were to be removable at the trustee's pleasure.

"In actual practice", says the taxpayer in its brief, "the trustees exercised exclusive and complete control and management of the trust property. They kept the records of the trust; they determined the policies with respect to declaration of dividends; they fixed the amounts of reserve to provide for contingent liabilities; they negotiated and executed the contracts for the disposal of oil and gas produced from the trust property and, in general, conducted all of the affairs of the trust whatsoever they might be."

The foregoing excerpts from the various declarations of trust, together with the taxpayer's own picture of the organization in action, would seem to bear out the Board's finding that, "Aside from the exclusive control resident in the trustees, petitioner's [taxpayer's] organization resembles in purpose and in form that of a corporation."

The Commissioner classified the taxpayer as an association taxable as a corporation.

The original oil lease, from W. O. Batson, which was finally assigned to the taxpayer and which is the trust property, contained the provision that "the lessee shall pay as rental or royalty for the use of said land one-sixth (1/6) of all oil produced and saved therefrom, said payment to be made in money or in kind at the lessor's option."

On February 10, 1922, this lease was assigned by F. A. Andrews to Thomas H. Lipps. The agreement of assignment contained the provision that, in addition to the payment of the one-sixth royalty specified in the original lease, the assignee would pay a one-twelfth royalty to the assignor. On April 25, 1922, Lipps assigned all his rights under the lease to the taxpayer's trustees.

The one-sixth royalty paid to Batson and the one-twelfth royalty paid to Andrews, by the taxpayer herein, during the taxable years, were as follows:

Year	Batson royalties	Andrews royalties
1925	$159,853.20	$79,926.60
1926	143,253.02	71,626.51
1927	70,946.34	35,473.17

The parties herein stipulated as follows:

"* * * The respondent [Commissioner] has for purposes of computing the 27½ percent depletion allowance to which petitioner [taxpayer] is entitled, reduced petitioner's gross income for each of the years 1925, 1926, and 1927 by the respective amounts of the above-mentioned royalties. Should the Board determine that petitioner's gross income should be reduced by the sum aforesaid in computing its depletion allowance, then the amount of depletion allowed by the respondent is correct. Should the Board determine that petitioner's gross income should not be reduced by said royalties in computing its depletion allowance, then said sums shall be added to the petitioner's gross income as determined by the respondent, for the purpose of determining the depletion allowance of 27½ percent."

This 27½-percent allowance will, in its proper place, be hereafter discussed.

The taxpayer has never acquired any property other than the lease assigned to it by Lipps, and has never sold any part of such lease. The taxpayer had a contract under which it sold all the oil produced, to the Associated Oil Company, and was under contract with the Norwalk Gas Company to sell to it all the gas produced. The taxpayer entered on its books the payments received from the purchase of its oil in an "Oil Runs Account", and charged against such account the royalties to Batson and Andrews.

Two oil wells were drilled on the taxpayer's holdings in 1922, under "turnkey" contracts with the Keck Drilling Corporation, for a fixed sum. The two wells were deepened in 1923, also under contracts. As of December 31, 1926, the total well costs of the taxpayer were $391,922.88. No further well costs were incurred during the years involved in the instant case.

The amounts paid to the contractors under the "turnkey jobs" were charged on the taxpayer's books as "Well Cost, No. 1 Well", and "Well Cost, No. 2 Well." The amounts paid to the contractors for drilling the wells included the total cost of the wells, and nowhere on the taxpayer's books was there any segregation made for the portion of the cost which represented materials going into the wells and the portion which represented labor and fuel incidental to the drilling.

The Commissioner, in the determination of the deficiencies here in question, allocated 40 percent of the total cost of the wells to tangible equipment, cost and allowed *depreciation* thereon. He determined that 60 percent of the cost of the wells represented in tangible drilling costs, such as labor, wages, fuel, etc., and added such 60 percent of the well costs to the lease account returnable to the taxpayer through *depletion*. The Commissioner denied the taxpayer the right to take depreciation deductions with respect to 60 percent of the well costs.

The parties stipulated that if the Board of Tax Appeals should determine that the taxpayer was not entitled to depreciation on the total well cost, then the Commissioner's determination of the taxpayer's liability in that respect was correct. But if the Board determined that the taxpayer was entitled to charge the total well cost to its well account and be allowed depreciation thereon, it was stipulated that the taxpayer should be entitled to an additional depreciation deduction as follows:

1925	$11,172.04
1926	8,953.04
1927	8,364.40

In 1926 some of the taxpayer's funds were used to purchase Julian Petroleum stock, which was sold in the same year at a profit.

The taxpayer's return for 1925 was filed on form 1041, a fiduciary trust form, and its returns for 1926 and 1927 were filed on form 1120, corporation income tax return. On the corporation returns, the kind of business was stated to be "Oil Producers."

In its opinion, the Board of Tax Appeals held that—

1. The taxpayer was an association and was taxable as a corporation for the years 1925, 1926, and 1927.

2. The reasonable allowance for depletion authorized as a deduction under the Revenue Act of 1926, in the case of oil and gas wells, is required to be equitably apportioned between lessor and lessee. The basis for determining such reasonable allowance, prescribed in section 204 (c) (2) of that act, is 27½ percent of gross income from the property, and such reasonable allowance so determined is required to be apportioned equitably between lessor and lessee. In other words, the Board approved the Commissioner's depletion allowance computed, as set forth in the stipulation already quoted, on the taxpayer's gross income *reduced*, for each of the years 1925, 1926, and 1927, by the amounts of royalties turned over to Batson and Andrews in each respective year.

3. The total cost of oil wells drilled under "turnkey" contracts represents the cost of improvement subject to depreciation allowance.

By its petition for review, the taxpayer appeals from the first two holdings of the Board. The Commissioner appeals from the third.

We will consider the three propositions *seriatim*.

1. Was the taxpayer, organized as a trust under a duly executed declaration of trust, taxable for income-tax purposes as an associa-

tion and therefore subject to taxation under the corporation tax rates?

The statute applicable to the above proposition is section 2 (a) (2) of the Revenue Act of 1926, which reads as follows:

"When used in this act—

"The term 'corporation' includes associations, joint-stock companies, and insurance companies."

The Treasury regulations and the leading Supreme Court case interpreting the foregoing section were fully discussed by this court in Trust No. 5833, *Security-First Nat. Bank* v. *Welch*, 54 F. (2d) 323, 326–327, certiorari denied, 286 U.S. 544. For this reason, we are quoting somewhat extensively from that opinion, all the italics being supplied for the purpose of the present discussion. In that case, the court said:

"The problem to be solved in this litigation is whether or not the appellant is an association within the meaning of the act of Congress above referred to. Section 701 (a) (2) of the Revenue Act of 1928 (26 U.S.C.A., § 2701 (a) (2)). *This subdivision of the revenue act is a re-enactment without change of language used in the Revenue Act of 1918, 1921,* 1924, and *1926.* After the enactment of the Revenue Act of 1918, the Commissioner of Internal Revenue, acting under the authority and direction of said act requiring him to prescribe and publish all needful rules and regulations for the enforcement of the act, adopted articles 1502 and 1504, amended August 31, 1925, of regulation 65 pertaining to the Revenue Act of 1924, *articles 1502 and 1504 of regulation 60* [69] *pertaining to the Revenue Act of 1926,* which are identical with articles 1312 and 1314 adopted under the Revenue Act of 1928. In view of the adoption of these interpretative regulations by the Commissioner, Congress, in the adoption of the Revenue Act of 1928, must be deemed to have considered and adopted the interpretation placed upon the statute by the Commissioner of Internal Revenue, in a matter as indefinite as the definition of 'an association.' Upon this subject, the Supreme Court, in an opinion written by Justice Butler, in *Brewster* v. *Gage*, 280 U.S. 327, 50 S.Ct. 115, 117, 74 L.Ed. 457, stated:

"'It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons. [Many cases cited.] * * *

"'The regulations promulgated under that section are substantially the same as the earlier regulations. Regulations 65, art. 1594; Regulations 69, art. 1594. The substantial reenactment in later acts of the provision theretofore construed by the Department is persuasive evidence of legislative approval of the regulation. [Many cases cited.] The subsequent legislation confirmed and carried forward the policy evidenced by the earlier enactments as interpreted in the regulations promulgated under them.'

"The regulations referred to first adopted, in their present form, by the amendment of Regulation 65, August 31, 1925, are as follows:

"'ART. 1312. Association. Associations and joint-stock companies include associations, common-law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has vested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 701.

"'ART. 1314. Association Distinguished from Trust. Where trustees merely hold property for the collection of income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, *and* the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 161–170 and by articles 861–891. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 701. *Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the act.*'

"These regulations in the present form are said to be based upon the decision of the Supreme Court in *Hecht* v. *Malley*, 265 U.S. 144, 44 S.Ct. 462, 467, 68 L.Ed. 949 (1923) dealing with the Revenue Acts of 1916 and 1918. The court in that case said:

"'We think that the word "association" as used in the act clearly includes "Massachusetts trusts", such as those herein involved, having quasi-corporate organizations under which they are engaged in carrying on business enterprises. What other form of "associations", if any, it includes, we need not, and do not, determine. * * *

"'We conclude, therefore, that when the nature of the three trusts here involved is considered, as the petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be deemed associations within the meaning of the act of 1918; this being true independently of the large measure of control exercised by

the beneficiaries in the Hecht and Haymarket cases, which much exceeds that exercised by the beneficiaries under the Wachusett trust. We do not believe that it was intended that organizations of this character—described as "associations" by the Massachusetts statutes, and subject to duties and liabilities as such—should be exempt from the excise tax on the privilege of carrying on their business merely because such a slight measure of control may be vested in the beneficiaries *that they might be deemed strict trusts within the rule established by the Massachusetts courts.*'"

It is perhaps worthy of passing comment that the taxpayer, in its opening brief, ends its quotation of the last sentence of the foregoing paragraph with the word "beneficiaries", omitting the part thereof that we have italicized. The quotation with this omission is, we think, misleading; for it might be implied that the Supreme Court meant to say that, had the measure of control vested in the beneficiaries been *greater*—instead of being "such a slight measure"—the organization *would* have been *exempt* from taxation as a corporation. This, of course, is not the law, and the appellant itself contends that control by the beneficiaries is part of the "double test" in classifying an organization as an association. This, in turn, would indicate that the Supreme Court was being guided, in part at least, by the "control" rule, rather than by the "business" rule. But if we complete the sentence and supply the clause that the taxpayer has omitted, the meaning of the court becomes clear; namely, that an organization will be taxed as a corporation even if there is virtually *no* control by the beneficiaries, provided that it is engaged in a business enterprise.

Trust No. 5833 was followed by the Board of Tax Appeals in *Trust No. 5522* and *Trust No. 5644, etc.*, v. *Commissioner*, decided April 26, 1933. 27 B.T.A. 1250.

There is ample additional authority for the proposition that the "business" test is now paramount.

In *Commissioner* v. *Atherton*, 50 F. (2d) 740, 742, this court said:

"The controlling feature of a trust is an association of individuals for administration of an estate for liquidation and equitable distribution, and the controlling distinction of an association is an association of individuals for administration of an estate for convenience and profit."

Other decisions by this court to the same effect are *Willis* v. *Commissioner*, 58 F. (2d) 121, 122, 123; and *Sloan* v. *Commissioner*, 63 F. (2d) 666, 669–670.

The same rule has been followed in other Federal jurisdictions.

In *Little Four Oil & Gas Co.* v. *Llewellyn* (C.C.A. 3), 35 F. (2d) 149, 150, certiorari denied, 280 U.S. 613, the court said:

"The theory that the distinction between trusts of these classes and their consequent liability for taxes is based on the powers exercised by the shareholders—great or little—is no longer seriously regarded. The real test is whether the shareholders or trustees, or

both combined, carry on business for profit, and, if they do, they constitute a business trust—in legal effect an association or a joint-stock company—with liability for taxes."

In connection with the expression "business trust" used in the foregoing excerpt, it might be observed in passing that, in the instant case, the transferable certificates, evidencing ownership of the "units", referred to the taxpayer as "a business trust."

Language similar to that used in the Llewellyn case, supra, was employed in *White* v. *Hornblower* (C.C.A. 1), 27 F. (2d) 777, 778:

"The taxability of the certificates depends on whether this trust constituted an 'association' under the revenue act. That it was a strict trust under Massachusetts law is too clear for discussion. But this is no longer the test of taxability as an 'association' under the Federal statutes. The measure of control over the trust vested in the beneficiaries does not seem to be the determining factor, but rather whether the trustees are conducting a business for profit or gain."

See also *Dunbar* v. *Commissioner* (C.C.A. 1), 65 F. (2d) 447, 451.

Examining the facts of the instant case, already fully set forth, we conclude that the taxpayer engaged in business and that it did so in a quasi-corporate capacity. Furthermore, we believe that in its dealings with the public, the syndicate conveyed the impression that it was a corporation. The use of the terms "dividends", "certificates", "officers", "company", and "Board", might easily lead a layman to assume that the entity was a corporate one. That this impression has actually been conveyed by the association may be inferred from the testimony of Lipps:

"Occasionally we have to sign a contract where an official title is required and we use it."

In its brief, the taxpayer asserts that "Mr. Lipps explained that at times some people with whom they [the trustees] dealt or contracted would require the use by the trustee of some official title, and in order to be *agreeable*, the trustees decided to give themselves titles." [Italics our own.] It is not unlikely that this accommodating practice of the trustees occasionally led those with whom they dealt to believe that the "business trust" was indeed a corporation. Nor would the mere isolated statement, buried in a lengthy declaration of trust, that "a trust and not a partnership or corporation is hereby created", necessarily remove such impression. It is elementary that a legal designation adopted by the parties is not conclusive, if, as a matter of law, the terms of the entire instrument and the acts of the parties thereunder, indicate that a different relationship actually resulted.

Applying the foregoing principles to the facts of the instant case, we are impelled to the conclusion that the taxpayer was engaged in business, that its organization was of a quasi-corporate character

and that, as a consequence, it was an "association" and should be taxed as a corporation under the provisions of the Revenue Act of 1926 and the Treasury regulations promulgated thereunder.

2. We next address our attention to the second question presented by the taxpayer's petition for review; namely, "Whether, in determining gross income for the purpose of applying the provisions of section 204 (c) (2), which provides for depletion based on 27½ per cent of gross income, the taxpayer's actual gross income should be reduced by rentals and royalties paid."

The text of section 204 (c) (2) of the Revenue Act of 1926 is as follows:

"In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

Section 234 (a) (8) provides as follows:

"(a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

"(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

Section 214 (a) (9), under the heading "Deductions Allowed Individuals", contains identical language, except that the word "deduction" instead of "deductions" is used in the last sentence.

According to the provision in section 204, supra, the 27½ per cent. is to be computed on "gross income." To determine what is "gross income", we must look to the statute itself:

"SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

"(a) The term 'gross income' includes gains, profits, and income derived from * * * trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

Section 233, referred to as the exception to the provisions of section 213, supra, reads as follows:

"SEC. 233 (a) In the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217, except that mutual marine

insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance."

Section 233 (b) refers to foreign corporations, and is not applicable here.

Section 217, referred to in section 233 (a) supra, deals with "net income of nonresident alien individuals", and is not relevant to the present controversy.

Section 230, also mentioned in section 233 (a), supra, treats of the rates of the tax to be levied upon the net income of every corporation, and is likewise not pertinent to the present discussion.

Section 232 provides:

"In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed", etc.

The pertinent portions of sections 233 and 234, referred to in section 232, have already been set out, supra. Section 206 deals with "net losses", and does not apply here. We have omitted the portion of section 232 that does not have reference to the problem now before us.

From the foregoing, it would appear that "gross income" means that income from which all deductions are to be made, save only the irrelevant marine insurance deduction noted above. Therefore, it would further appear that the amounts paid out by the taxpayer as royalties were part of its gross income, within the meaning of the 27½ percent depletion provision of section 204 (c) (2).

This construction is borne out by the provisions of section 234:

"SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

"(1) * * * rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity:"

Since rentals and similar payments are to be deducted in order to arrive at net income, it would seem to follow that such amounts, before they are deducted, form part of gross income. Almost identical language is used in section 214 (a) (1), which refers to "Deductions Allowed Individuals."

Therefore, from an examination of the various provisions of the act, the inference is strong that rentals and royalties were intended to form part of "gross income", and consequently should not be deducted therefrom in computing the 27½ percent allowance.

Let us next analyze section 204 (c) (2), supra, with reference to its context.

Section 204 (a) reads as follows:

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that——" [Italics our own.]

Here follow eleven paragraphs, each containing the word "basis."

Subsection (b) deals with the "basis" for determining the gain or loss from the sale of property acquired before March 1, 1913.

Subsection (c) treats of the "basis" for allowing depletion except that—

(1) In the case of mines, the basis shall be discovery value, etc.

Then we come to the subsection controlling here, 204 (c) (2), supra, where for the first time the word "basis" is dropped, and, as we have seen, the word "allowance" only is used.

The language of section 204 (c) (2), as it appeared in the act of 1926, was greatly different from that of the corresponding section in the act of 1924. See 26 U.S.C.A. 935, historical note, page 41. The earlier section contained no special provision for oil and gas wells only.

From the foregoing, it may legitimately be inferred that Congress intended to substitute a fixed, arbitrary allowance for the loose "basis" of computation of the earlier statute.

Indeed, this inference would seem authorized by the language of the Supreme Court in *U.S.* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 461, 466:

"But the 'discovery value' provision was eliminated from the act of 1926, which is applicable here, and the taxpayer was permitted to calculate depletion on the basis of cost alone, § 204 (c), or else to deduct an arbitrary allowance, fixed by the statute, without reference to cost or discovery value, at 27½ percent of gross income from the well.

* * * * * * *

"It was eliminated under the 1926 act, being no longer necessary, as the statute omitted the 'discovery value' provision *and substituted the arbitrary percentage allowance for depletion.*"

It may be regarded as significant that the Revenue Act of 1932 specifically provides for the exclusion of rents and royalties from gross income, here contended for by the Commissioner. Section 114 (b) (3) reads as follows:

"*Percentage depletion for oil and gas wells.* In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, *excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property.* Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph." [Italics our own.]

It will be observed that, with the exception of the provision for the exclusion of rents or royalties, the 1932 enactment is identical with the corresponding section of the Revenue Act of 1926, section 204 (c) (2), supra. This new qualifying phrase, not found in the act of 1926, amounts, it would seem, to a legislative interpretation of

the act of 1926 as *not* excluding rents or royalties from gross income. It is at least a legislative recognition that the language used in the 1926 section was ambiguous. And if ambiguity exists, it must be resolved in favor of the taxpayer.

In *Hecht* v. *Malley*, supra, at page 156, the Supreme Court used the following language:

"It is a new statute, supplanting and changing the former statutes in many respects, *and in which there is a significant change of phraseology*, incorporated in the general definition clause made applicable, expressly, to every provision of the act."

So here we believe that the "change of phraseology" in the 1932 act is "significant" of the legislative construction of the act of 1926.

In this brief the Commissioner says:

"The taxpayer is in effect contending that it should be allowed 27½ percent of the whole income derived from the well, and that the lessor should also be allowed something for depletion, although there is no suggestion as to what amount this ought to be. If this were the proper view it would follow that in a situation where there was a lease, which is a common situation, the lessee could have the statutory limit of the deduction (27½ percent), and the lessor could also have an additional deduction."

But the Commissioner's argument is not one that should be addressed to the courts, but to the lawmaking body. Congress did, indeed, change the law, in 1932, so as to meet the Commissioner's objection. But that change had not yet been made in the statute that we are here considering, and we must take it as we find it.

That royalties paid out by a lessee should be included in his gross income was the precise holding of the court in *Comar Oil Co.* v. *Burnett* (C.C.A. 8), 64 F. (2d) 965, 967–968, certiorari denied, 78 L.Ed. 76, October 9, 1933. There the court was construing section 213 (a) of the act of 1921, defining "gross income" in language virtually identical to that of section 213 (a) of the act of 1926, supra. In that case the court used the following language:

"It will be apparent upon examination of the statute (section 213 (a)) that the term 'gross income' is broad in scope; broad enough to include, in the case of a lessor, rents or royalties paid to him by the lessee [cases cited]; *broad enough also to include, in the case of a lessee, rents or royalties paid by him to the lessor owner; and the practice has been to include them as gross income in the return.* [Cases cited.]

"It is one of the contentions of petitioners that these overriding royalties should be treated in the same manner as the original royalties. We think this contention is sound in so far as it results in the inclusion of both the original royalties and the overriding royalties in the category of 'gross income.'

"We are not insensible to the forceful argument of petitioner that neither original royalties nor overriding royalties should be included in gross income of the lessee, sublessee, or transferee. The argument is one, however, which we think should more properly

be presented to the Congress than to the courts. The inclusion of royalties in the gross income of the lessee not only finds support in the language of sections 233 and 213 of the Revenue Act of 1921 but also in the actual practice as established during a considerable number of years."

We advance, finally, to the troublesome question of equitable apportionment, so earnestly insisted upon both by the Commissioner and by the Board.

As we have seen, this subject is covered by section 214 (a) (9) and section 234 (a) (8), supra.

In the first place, it is observable that both sections deal with "mines, other natural products, and timber", as well as with oil and gas wells. They are therefore, in a sense, general provisions. It is elementary that "General language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment." *Ginsberg & Sons* v. *Popkin*, 285 U.S. 204, 208.

Secondly, the section specifies that the deduction—i.e., the "reasonable" deductions—*allowed by that paragraph*—shall be equitably apportioned. But that does not mean that the "arbitrary" deduction allowed by section 204 (c) (2) should likewise be "equitably" apportioned. Here again we are confronted by the rule that all doubtful intendments should be construed in favor of the taxpayer.

The Commissioner has not cited a single case in point as sustaining his position. *Night Hawk Leasing Co.* v. *Burnet* (C.A.D.C.), 57 F. (2d) 612, 613, dealt with a *mine*, and not an oil well. The depletion rule as to oil wells is, as we have seen, different from that applicable to mines. *American Trust Co.* v. *Commissioner* (C.C.A. 9), 31 F. (2d) 47, 48, had to do with the bad debt of a bank. *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, 306, is cited for the proposition that the Commissioner's method of computation was "reasonable." But the page cited deals with the reasonableness of the Commissioner's computation as to *bonus* payments *received by the lessor*. Royalties or bonuses *paid by the lessee*, as constituting the *lessee's* gross income, were not involved in that case. Furthermore, the controversy involved the Revenue Act of 1918. Similarly, *Palmer* v. *Bender*, 287 U.S. 551, 553; *Burnet* v. *Harmel*, 287 U.S. 103, 104, 112; and *Bankers' Coal Co.* v. *Burnet*, 287 U.S. 308, 309–310, 311, all treated of royalties or bonuses *received* and not *paid* by the taxpayer. Moreover, none of these cases involved section 204 (c) (2) of the act of 1926. *Signal Gasoline Corporation* v. *Commissioner* (C.C.A. 9), 66 F. (2d) 886, 888–890, contained the following language, which at once reveals its relevancy to the instant case: "The question for determination is, Has petitioner such rights in the gas produced from the properties which amount to the necessary economic interest to entitle it to depletion under the law?" In the present litigation there is no question that the taxpayer is entitled to depletion. The only problem is as to how that depletion is to be

computed. There was no question of "equitable apportionment" involved in that case.

We are of the opinion that the holding of the Board of Tax Appeals as to this question should be reversed.

3. We take up, finally, the question presented by the Commissioner's petition for review; namely, Whether the taxpayer is entitled to a deduction for depreciation of its oil wells, drilled for the taxpayer under "turnkey" contracts, based on the total cost of the wells, or whether there should be eliminated from such basic cost that part of the total expenditure representing the drilling contractor's intangible drilling costs, such as wages, fuel, repairs, and hauling.

Section 214 (a) of the Revenue Act of 1926 provides:

"In computing net income there shall be allowed as deductions: * * *

"(8) A reasonable allowance for the exhaustion, wear, and tear of property used in the trade or business including a reasonable allowance for obsolescence. * * *

"(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

Save for the omission of a sentence not material here, section 234 (a) (7), relating to corporations, is identical with 214 (a) (8). Section 234 (a) (8) and section 214 (a) (9) are, as we have seen, virtually identical. The former, however, relates to corporations.

Treasury Department Regulations 69, promulgated under the Revenue Act of 1926, contain the following aticles:

"ARTICLE 223. *Charges to capital and to expense in the case of oil and gas wells.* Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, insofar as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. * * *"

"ARTICLE 225. *Depreciation of improvements in the case of oil and gas wells.* Both owners and lessees operating oil and/or gas properties will, in addition to and apart from the deduction allowable for depletion as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with

the option exercised by the taxpayer under article 223. The amount deductible on this account shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired. * * *"

The instant case was decided by the Board on September 3, 1932. Since that time, the Supreme Court, in a series of decisions handed down on March 13, 1933, has held that expenditures for developing and drilling oil wells are returnable by the depletion allowance, and not by an additional allowance for depreciation.

In *U.S. Dakota-Montana Oil Co.*, 288 U.S. 459, 462–463, 467, the respondent, in making its tax return of income derived from its operation of oil wells, claimed a deduction from gross income of a depreciation allowance on account of the capitalized costs of preliminary develpment and drilling. The Commissioner refused to allow the deduction claimed, ruling that it was for depletion, not depreciation, and was therefore included in the statutory depletion allowance of 27½ percent of the gross income, which the respondent had also deducted.

Construing the identical statutes and Treasury regulations that we are here considering, the Supreme Court said, after discussing article 223 of Regulations 69, supra:

"Article 225 [supra] limits the depreciation for which an allowance may be made to that of 'physical property, such as machinery, tools, equipment, pipes, etc.' We do not doubt that the effect of this language is to require the taxpayer to look to the depletion allowance, in this case 27½ percent of gross income, for a return of the costs of developing and drilling the well, which are involved here."

In the instant case, the taxpayer earnestly insists that its "completed oil well * * * represents an improvement on the property", and that it "is entitled, under articles 161 and 225 of Regulations 69, to deductions for depreciation of this improvement to return to him the most thereof." Article 161 provides in general terms for "A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade", etc., to be "for convenience" "referred to as depreciation."

Under similar—but, as we shall see presently, not identical—circumstances, the respondent in the Dakota-Montana case made the same contention. The Supreme Court thus disposed of the argument:

"Respondent challenges the validity of the regulations thus applied as in conflict with § 234 (a) (8) [supra], which allows the deduction of a reasonable allowance 'for depreciation of improvements' in addition to the deduction for depletion. It is urged that the drill hole is an 'improvement' of the taxpayer's oil land and that no logical distinction in accounting practice can be made between the cost of this improvement and the cost of buildings and machin-

ery placed on the property for the operation of the well, for which depreciation should admittedly be allowed.

"The Government argues that the well itself is not tangible physical property which wears out with use so as properly to be the subject of depreciation, and that in any event the regulations are based upon the practices of the oil industry and are within the requirements of § 234 (a) (8) that a reasonable allowance for depletion and depreciation of improvements be made in all cases under rules and regulations to be prescribed by the Treasury Department.

"We do not stop to consider whether, under correct accounting practice, an anticipated loss of a part of the capitalized cost of developing and drilling an oil well because of decreased utility of the well would be described or treated differently than wear and tear of the machinery used in production, or whether an allowance for the former serves a purpose logically distinguishable from one for the latter. For the issue before us, whether the statute requires the former to be treated as depletion, is resolved by the history of the legislation and the administrative practice under it."

After reviewing the legislative and administrative history referred to—a history identical, as we have seen, to the one that must guide us here—the Supreme Court concluded:

"Respondent argues whatever effect may be attributed to earlier reenactments, that of 1926, which is applicable here, is without force because § 204 of that act abandoned discovery value as the basis of depletion and permitted the taxpayer to abandon cost and substitute a fixed allowance of 27½ percent of gross income from the well. We think the contention unfounded and that, on the contrary, what was included in the reasonable allowance for depletion by the established construction of the earlier acts give significant content to the word as used in the act of 1926. There is no ground for supposing that Congress, by providing a new method for computing the allowance for depletion intended to break with the past and narrow the function of that allowance. The reasonable inference is that it did not and that depletion includes under the 1926 Act precisely what it included under the earlier acts. The regulations under the 1926 Act so ruled, as has been shown, by continuing the provisions of earlier regulations under which costs of development and drilling were returnable by the depletion allowance and not by an additional allowance for depreciation."

See also *Petroleum Exploration* v. *Burnet*, 288 U.S. 467; *Burnet* v. *A. T. Jergins Trust*, 288 U.S. 508, 516; *Pleasant* v. *Missouri-Kansas-Texas R. Co.* (C.C.A. 10), 66 F. (2d) 842, 847.

The taxpayer herein, however, earnestly argues that the Supreme Court cases just referred to are not applicable to the instant case, inasmuch as those cases did not involve "turnkey" contracts, in which the owners or the lessees pay a specfic contract price for their oil wells, which are turned over to them complete.

We cannot concur with the taxpayer's view, which would make a distinction between cases involving turnkey contracts and those cases in which the owners or the lessees drill their own wells. An oil well either is or is not a physical improvement or asset, upon the full value of which depreciation either should or should not be allowed. The essential character of an oil well cannot depend upon who drilled it. Steel is steel and pipe is pipe and labor is labor, no matter who contributes them.

The taxpayer relies chiefly upon three recent cases decided by circuit courts of appeal, in which there may be found language that, at first blush, might be understood as favorable to its contention. Analysis of each case, however, discloses that it is in reality no authority for the taxpayer's views.

In the case of *J. K. Hughes Oil Co.* v. *Bass* (C.C.A. 5), 62 F. (2d) 176, 177, 178, certiorari denied, 289 U.S. 726, the court seemed inclined to the view that we are here sustaining: namely, that, in principle, there is no difference between money expended for a completed well under a turnkey contract and that disbursed when the well is drilled by a contractor on a footage basis. There, however, the taxpayer subtracted the value of the physical properties making up the wells, from the total price paid for them, and deducted the difference as an expense. The Commissioner refused to allow the deduction, but treated the entire sums for the wells as capital expenditures, and made provision for their return to the taxpayer by allowing depletion deductions on the entire amount. Thus it will be seen that in that case the situation of the parties was not the same as that which prevails here; for there it was the *taxpayer* who contended that there was no difference between a turnkey contract and a footage contract, while the Commissioner refused, according to the taxpayer's statement on appeal, "to allow the plaintiff to deduct as an expense in computing its taxable income, intangible drilling and development cost incurred by it in developing an oil or gas lease owned by it, and force the plaintiff to recover these costs through annual depletion and depreciation deduction, solely because these costs were incurred under 'turnkey' drilling contracts, when the right to take the deduction would, under settled rules and decisions of the Treasury Department, have been allowed had the wells been drilled either with the plaintiff's own labor and machinery, or under the ordinary footage contracts."

The language there used by the court is significant:

"It is alleged that there is no reason in or basis for the distinction, for the purposes of capitalization, between moneys which an owner pays out when he drills a well himself, on his own property, with his own labor and equipment, or when a contractor drills it for him on a footage basis and the same amount of drilling and development costs paid out to a contractor as a part of the whole cost price of a turnkey job.

"If the appellant claims no more than that the distinction is supported by no evident principle, that subjected to analysis moneys

laid out in a completed improvement, such as an oil well, are no less and no more capital expenditures when it is furnished by a contractor on a footage basis than when it is done under a turnkey contract, *I think we could agree with him.* If, however, he means to claim that, because this is so, he is entitled to have his deduction allowed, we cannot. *The burden upon him to overcome the prima facies of the action of the Commissioner is not discharged* by a showing that the treatment he asks for is no more unreasonable or unjust than one which, under other circumstances, has been actually accorded to him by the Commissioner.

"But this is not the whole of it. We are not concerned here with the question whether the regulation invoked by analogy is reasonable or unreasonable. [Cases cited.] *We have here only the question whether appellant has sustained the burden of showing that the action of the Commissioner is unreasonable and invalid.*" [Italics our own.]

From the forgoing language it is clear that the court there was controlled by the presumption in favor of the correctness of the Commissioner's determination, and not by the asserted distinction between turnkey contracts and other bases of oil-well drilling. In the instant case, that very presumption of correctness is in favor of the view which is here maintained by the Commissioner, and which we are sustaining.

It is true that in the Hughes Oil case, the court, in closing its opinion, supported, as "in accord with practice, principle, and authority", as well as because of the above presumtion, the Commissioner's view "that a producing oil well is a physical property having a useful life beyond the taxable year, and that its aquisition for a price increases the invested capital of the purchaser to the extent of that price." But, as we have seen, this language was not necesary to the decision, which was based chiefly on the presumption of correctness attending the Commissioner's determination. Furthermore, the court cites no Supreme Court case in support of this statement. Indeed, the discussion by the highest tribunal, in the Dakota-Montana case, supra, would indicate that the Supreme Court, by holding that "costs of development and drilling were returnable by the depletion allowance and not by an additional allowance for depreciation", disapproved of this "physical property" theory, as being opposed to "the history of the legislation and the administrative practice under it."

In the Hughes Oil case the court cited three decisions of circuit courts of appeals, in support of this "physical property" theory. Two of them did not involve oil wells, which, as we have seen, have been regarded as *sui generis* both by Congress and by the Supreme Court, and the third, *Dakota-Montana Oil Co.* v. *U.S.* (Ct. Cl.), 59 F. (2d) 853, was reversed by the Supreme Court in the Dakota-Montana Oil case, supra.

The second case cited by the taxpayer herein, in support of its contention that it is entitled to depreciation on the total cost of its oil

wells, is *Ramsey* v. *Commissioner* (C.C.A. 10), 66 F. (2d) 316, certiorari denied, 78 L.Ed. 85, October 16, 1933. There the Commissioner declined to permit a double deduction for the same costs, holding that since the taxpayer had exercised his option to treat certain items as expenses and had taken credit therefor, he could not later retroactively elect to treat them as capital expenditures. Here, again, we are constrained to point out, by means of italics, important omissions in the taxpayer's quotation from the opinion, as contained in its reply brief:

"Many cases are cited by counsel in which this particular regulation was involved. Only one deals with the validity of the regulation [Reg. 69, art. 223, supra], *Sterling Oil & Gas Co.* v. *Lucas* (D.C.Ky.) 51 F. (2d) 413, in which Judge Dawson held it to be valid, and the Circuit Court of Appeals affirmed, 62 F. (2d) 951, assuming, without deciding, its validity. * * * In *Island Petroleum Co.* v. *Commissioner* (C.C.A. 4) 57 F. (2d) 992, the court held the regulation not applicable, but its validity was recognized. Other cases involve 'turnkey' contracts, that is, where a contractor erects the derrick, drills and cases the well, and turns it over fully equipped. *Hughes Oil Co.* v. *Bass* (C.C.A. 5), 62 F. (2d) 176; *Old Farmers Oil Co.* v. *Commissioner*, 12 B.T.A. 203. The contract price of such a job, including recoverable equipment, was held not to be within the incidental costs covered by the regulation. These cases do not hold the regulation invalid; *they hold the taxpayer's proof did not call for its application.* It is not a question whether the well is drilled under contract; it is a question whether the labor costs have been segregated from the equipment expense. Other cases present the question, *not present here*, whether if such costs are capitalized, return thereof should be had through depreciation or depletion." [Many cases cited.]

We have italicized only the portions of the decision omitted by the taxpayer in its quotation that we deem are significant, as at once demonstrating that the Ramsey case is not in point here.

The third decision cited by the taxpayer under this heading is *State Consol. Oil Co.* v. *Commissioner* (C.C.A. 9), 66 F. (2d) 648, 649–650. There the expenditures were made in connection with oil well drilling operations under a contract by the terms of which the taxpayer was to drill wells on two lots belonging to the other party to the contract, and the proceeds resulting from any oil and gas discovered were to be applied, first, to reimbursing the taxpayer for its expenses in drilling, equipping, and operating the wells; second, to paying the landowner $1,400; and thereafter the petitioner was to receive a deed to a one-half interest in the property which was thenceforth to be jointly operated. We have before us here no such contract. As Judge Mack pointed out in the opinion in that case, "The expenditures in controversy were merely to be exchanged for a capital asset or to be recouped out of the land." The Commissioner there contended "that the Regulations were not

intended to apply to one who drills a well upon land in performance of a contract to purchase an interest therein." The court concurred in that view, and, quoting the Hughes Oil case, supra, adverted to "The burden upon petitioner * * * 'to overcome the prima facies of the action of the Commissioner'", etc. The case is not in point here.

In the case of *Graham Loftus Oil Company* v. *Commissioner*, 27 B.T.A. 1301, 1303–1304, promulgated April 27, 1933, the taxpayer paid for the drilling of its oil wells on the turnkey contract system, and, as in the instant case, there appeared to have been no segregation on its books between the amounts paid for such incidental expenses as wages, fuel, repairs, hauling, etc., and the amounts paid for physical property, such as machinery, tools, equipment, pipes, etc., used in connection with the wells. There, as here, the Commissioner, in determining the deficiencies for each of the years involved, allocated 40 percent of the cost of drilling each of the wells as representing the cost of machinery, tools, equipment, pipe, etc., and allowed depreciation thereon at the rates claimed by the taxpayer. The remaining 60 percent of the drilling cost was allocated to intangible development costs to be added to the cost of the taxpayer's leases and recoverable through depletion allowances and not by way of depreciation. The Board there said:

"Petitioner has offered no evidence which would establish or tend to establish that this allocation made by the respondent was unreasonable and unfair.

"In the absence of such evidence we must hold respondent's determination in that respect correct. Petitioner does not contest the depreciation deductions which respondent allowed, but only those which he did not. As to these, respondent appears to have followed his regulations, which, as we have frequently pointed out, have recently received the approval of the Supreme Court in the cases which we have cited. [The Dakota-Montana Oil Co., Petroleum Exploration, and Jergins Trust cases, supra.]"

The taxpayer asserts that in the Graham Loftus case, the Board of Tax Appeals "misinterpreted" the Supreme Court's decision in the Dakota-Montana Oil case. We do not think so.

We therefore hold that the Board's decision, in so far as it was based on the holding that the taxpayer was an association and therefore taxable as a corporation, is affirmed; that, in so far as it rests on the holding that the Commissioner's computation of the 27½ percent depletion allowance was properly based on the taxpayer's gross income after the amounts of the royalties paid by the taxpayer had been deducted therefrom, it is reversed; and that, in so far as it is based on the holding that the entire cost of the wells drilled under turnkey contracts is subject to a depreciation allowance, it is reversed.

Affirmed in part, and reversed in part.

(Endorsed:) Opinion. Filed Apr. 12, 1934. Paul P. O'Brien, clerk.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 7190

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

TWIN BELL OIL SYNDICATE, RESPONDENT

and

TWIN BELL OIL SYNDICATE, PETITIONER

v.

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Upon petitions to review an order of the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this court, that the portion of the order of the said Board of Tax Appeals in this cause based on the holding that the taxpayer was an association and therefore taxable as a corporation be, and hereby is affirmed; that the portion of the order based on the holding that the Commissioner's computation of the twenty-seven and one-half percent (27½%) depletion allowance was properly based on the taxpayer's gross income after the amounts of the royalties paid by the taxpayer had been deducted therefrom, and the portion of the order based upon the holding that the entire cost of the wells drilled under turnkey contracts is subject to a depreciation allowance, be and hereby are reversed.

(Endorsed:) Judgment. Filed and entered April 12, 1934. Paul P. O'Brien, clerk.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 7190

TWIN BELL OIL SYNDICATE, PETITIONER

v.

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

v.

TWIN BELL OIL SYNDICATE, RESPONDENT

Certificate of clerk United States Circuit Court of Appeals for the Ninth Circuit to record certified under rule 38 of the Revised Rules of the Supreme Court of the United States

I, Paul P. O'Brien, as clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing two hundred twenty-four (224) pages, numbered from and including 1 to and including 224, to be a full, true and correct copy of the entire record of the above entitled case in the said Circuit Court of Appeals, made pursuant to request of Honorable Frank J. Wideman, Assistant United States Attorney General, counsel for Commissioner of Internal Revenue, and certified under rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 6th day of July, A.D. 1934.

[SEAL]

PAUL P. O'BRIEN, *Clerk.*

SUPREME COURT OF THE UNITED STATES

Order allowing certiorari

Filed October 8, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

TWIN BELL OIL SYNDICATE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above entitled cause on April 12, 1934, reversing the decision of the Board of Tax Appeals in part.

QUESTION PRESENTED

Whether the depletion allowance to which a lessee's assignee is entitled under Section 204 (c) (2) of the Revenue Act of 1926 is 27½ percent of

the gross income from the leased wells excluding or not excluding amounts paid by it as rents and royalties.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 15–18.

STATEMENT

The facts as found by the Board and as stipulated (in part) by the parties are as follows:

The taxpayer is a California syndicate organized in 1922 for the purpose of acquiring a certain oil and gas lease and operating it. (R. 36–41.) Both the Board and the court below have held that the syndicate is to be treated as a corporation for Federal income-tax purposes.

The original lessee of the properties was one F. A. Andrews, who secured a twenty-year lease from the owner, W. O. Batson, in December, 1921. In addition to certain monthly rentals to be paid until drilling should commence the lessee agreed to pay as rental or royalty for the land "one-sixth (1/6) of all oil produced and saved therefrom, said payment to be made in money or in kind at the Lessor's option." (R. 86–90.)

On February 10, 1922, Andrews assigned all of his right, title and interest in the lease to Thomas H. Lipps, who agreed to perform all of the covenants of Andrews and that in addition to the one-sixth royalty agreed to be paid to the lessors, he

would pay to Andrews "one-twelfth (1/12) of all petroleum, oil, gas and other oil products, and casing-head gasoline, produced and saved from each and all wells" on the property either in cash or in kind. (R. 95–97.)

On April 25, 1922, Lipps assigned all his right, title and interest in the lease to the trustees of the syndicate, who agreed to comply with all of the terms and conditions of the original lease and also of the assignment by Andrews. (R. 103–105.)

The one-sixth royalty and the one-twelfth royalty paid to Andrews during the taxable years 1925, 1926 and 1927 were as follows (R. 18):

Year	Batson Royalties	Andrews Royalties
1925	$159,853.20	$79,926.60
1926	143,253.02	71,626.51
1927	70,946.34	35,473.17

In the audit of the taxpayer's returns for 1925, 1926 and 1927, the Commissioner held that the above-mentioned royalties should be deducted from the gross income from the wells before computing the 27½ percent deduction for depletion allowed under Section 204 (c) (2). (R. 18–19.) The Commissioner determined deficiencies as the result of this and other adjustments, and the taxpayer appealed to the Board.

The Board sustained the Commissioner's allowance for depletion, but decided against the Commissioner on another issue. Both parties appealed.

The Circuit Court of Appeals for the Ninth Circuit reversed the Board on the issue concerning depletion, which was one of two issues in the syndicate's appeal. That court held that the 27½ percent deduction should be computed on the gross income of the syndicate without deduction for the rents and royalties. The other issues involved in the case were decided for the Government and are not here involved.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the term "gross income from the property" as used in Section 204 (c) (2) of the Revenue Act of 1926, *infra,* means gross income of the taxpayer as defined in Section 213 (a) of that Act, *infra.*

2. In holding that Section 204 (c) (2) should be construed independently of Section 234 (a) (8).

3. In holding that in the case of an assignee's lessee paying rents and royalties to his assignee and the lessor the term "gross income from the property" in Section 204 (c) (2) means gross income including such rents and royalties.

4. In failing to hold that the "gross income from the property" in which the percentage deduction for depletion is based under Section 204 (c) (2) means gross income less rents and royalties.

REASONS FOR GRANTING THE WRIT

1. We believe that the case conflicts in principle with the decision in *Darby-Lynde Co.* v. *Alexander,* 51 F. (2d) 56 (C.C.A. 10th), certiorari denied, 284 U.S. 666. In this case the court held that the term "gross income from the property" meant the gross income of the taxpayer as defined in Section 213. In the *Darby-Lynde* case, the court rejected that construction of Section 204 (c) (2), holding that the term "gross income from the property" meant gross income from production and did not include proceeds from the sale of the oil properties themselves, notwithstanding the fact that such proceeds constitute gross income. To this extent the two decisions are in conflict. Moreover, if the construction of the statute by the court below is correct and the taxpayer may take depletion based on the total gross income from the property including the rents and royalties, the depletion allowance of the taxpayer, lessor and assignor combined will be based on an amount in excess of the gross income from production. It is clear that the lessor and the assignor have an economic interest in the property within the meaning of *Palmer* v. *Bender,* 287 U.S. 551, and as they are entitled to one-fourth of the gross income from production, they would be allowed to base their deduction on that one-fourth, so that the allowance of all would be based on five-fourths of the gross income from production,

which is contrary to the decision in the *Darby-Lynde* case, *supra.*

2. Independently of a conflict, we believe that the result just mentioned is one never intended by Congress. In so far as that result has been reached by a literal construction of subdivision (2) of Section 204 (c) divorced from subdivision 204 (c) as a whole and from Section 234 (a) (8), which is the general provision granting allowances for depletion to corporations (Section 204 (c) merely providing the basis of the computation), the court below has ignored the cardinal rule recently reaffirmed by this Court that a statute must be construed as a whole and in such a way as to carry out the intention of Congress. *Helvering* v. *New York Trust Co.,* No. 873, October Term, 1933, decided May 28, 1934; *Rockford Life Insurance Co.* v. *Helvering,* No. 722, October Term, 1933, decided May 21, 1934.

The question involved here has not been decided by the case of *Comar Oil Co.* v. *Burnet,* 64 F. (2d) 965 (C.C.A. 8th), certiorari denied, 290 U.S. 652, upon which the court below relied. That case arose under the Revenue Act of 1921, which contained no provisions analogous to Section 204 (c) (2) of the Revenue Act of 1926, and the question involved was whether royalties received by an assignee of a lessee out of first oil produced and paid over to his assignor as consideration for the lease should be included in the assignee's gross income and if so, whether the payments could be deducted as business expenses.

3. The question of the proper construction of this provision in the Revenue Act of 1926 and of the same provision in the Revenue Act of 1928, is one of general importance. The Bureau of Internal Revenue states that refund claims based on an interpretation of the statute similar to that made by the court below now reach approximately $10,000,000.

Wherefore, it is respectfully submitted that this petition should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

JULY 1934.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 14–27) is reported in 26 B.T.A. 172. The opinion of the Circuit Court of Appeals is reported in 70 F. (2d) 402.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 12, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED, STATUTE INVOLVED, ETC.

A statement of the question presented, statute involved, specification of errors to be urged, and a

statement of the case will be found in the foregoing petition.

ARGUMENT

Section 234 (a) (8) of the Revenue Act of 1926, *infra,* provides for the deduction of a reasonable allowance for depletion to corporations and provides that in the case of a lease the deduction shall be equitably apportioned between the lessor and the lessee. Section 214 (a) (9), *infra,* grants an allowance under similar conditions to individuals.

Section 204 (c) *infra,* provides that the basis on which depletion is to be allowed is the same as that provided in the case of a sale with certain exceptions. One of these exceptions is set forth in subdivision (2) as follows:

> In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

We submit that the authority for the deduction for depletion by corporations is contained only in Section 234 (a) (8), that Section 204 (c) merely provides the basis for the allowance and subdivision (2) merely provides that a percentage of the gross income shall constitute the basis in the case

of oil and gas wells, provided (1) that an allowance so computed is not less than that otherwise computed and (2) does not exceed 50 percent of the net income of the taxpayer computed without the benefit of the depletion deduction.

We submit that this analysis of the depletion provisions shows clearly that Section 204 (c) (2) is to be construed in conjunction with Section 234 (a) (8) which authorizes the deduction and that when so construed the provision for equitable apportionment between lessor and lessee is applicable whether depletion is based on cost or fair market value as of March 1, 1913, or is based on a percentage of gross income.

The legislative history of Section 204 (c) (2) does not disclose any intention on the part of Congress to do away with the requirement of apportionment between lessor and lessee in the case of the percentage deduction. The provision was inserted merely to put an end to the difficulties occasioned by the computation of depletion on the basis of discovery value in the case of oil and gas wells. S.Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18; H.Rep. No. 356, 69th Cong., 1st Sess., pp. 31–32.

Hence, Section 204 (c) (2) must be construed in the light of the mandate of Section 234 (a) (8) that depletion must be equitably apportioned between lessor and lessee. *Night Hawk Leasing Co.* v. *Burnet*, 57 F. (2d) 612 (App.D.C.).

In the present case the taxpayer was the sublessee and operator of the property. It received the total income from the sale of oil and gas but was obligated to pay the lessor one-sixth and its assignee one-twelfth, a total of three-twelfths or one-fourth.

The Commissioner and the Board solved the problem of apportionment in the present case by holding that the phrase 27½ percent of the "gross income from the property" as employed in Section 204 (c) (2) meant the gross income from production less the amounts which the taxpayer was obliged to pay to his assignee and the lessee (i.e., one-fourth of the total). In that way the taxpayer would be allowed 27½ percent of the gross income from production which it was permitted to retain and his assignee and the lessor together would receive an allowance based on 27½ percent of the remaining one-fourth. Obviously, the lessor and the taxpayer's assignee have an economic interest in the property and are entitled to a deduction for depletion. *Palmer* v. *Bender,* 287 U.S. 551; *Helvering* v. *Falk,* 291 U.S. 183. But under the construction of the statute by the court below the taxpayer, the lessor and the assignee together would be allowed a deduction equal to 27½ percent of five-fourths of the gross income from the property.

It is unreasonable to suppose that Congress intended that a multiplication of interests in the property should result in a greater allowance for

depletion than the owner himself would be allowed if he operated the property. It is far more reasonable to assume that Congress intended that the percentage deduction allowable to all having an economic interest should amount in the aggregate to 27½ percent of the gross income from the property; that is, from production. There is no apportionment on any other theory.

It may be conceded that the portion of the income from the property which the taxpayer pays over to its assignee and the lessor is required to be reported in its gross income in its tax return (*Comar Oil Co.* v. *Burnet,* 64 F. (2d) 965 (C.C.A. 8th), certiorari denied, 290 U.S. 652), but the court below incorrectly assumed that the term "gross income from the property" means the taxpayer's gross income as defined in Section 213. See *Darby-Lynde Co.* v. *Alexander,* 51 F. (2d) 56 (C.C.A. 10th), certiorari denied, 284 U.S. 666.

In the *Darby-Lynde Company* case, the taxpayer argued that the proceeds from the sales of the oil property itself (in addition to proceeds of sales of oil and gas) constituted gross income and should be included in the gross income on which the percentage deduction was based. But the court rejected that argument, holding that the term "gross income from the property" as employed in Section 204 (c) (2) meant gross income from production.

Thus, the decision of the court below holding that "gross income from the property" means gross in-

come as defined in Section 213 conflicts in principle with that decision.

The decision in *Comar Oil Co.* v. *Burnet, supra,* is not opposed to our view in this case. It did not involve any question of depletion and arose under the Revenue Act of 1921 which contained no provision analogous to Section 204 (c) (2). The court merely held that amounts which an assignee received out of the first oil and gas produced and paid over to its assignee and the lessor constituted gross income and that they could not be deducted as business expenses, since they represented the cost of acquiring a capital asset.

The court below reached a result opposed to what we believe to be the clear intent of Congress by construing Section 204 (c) (2) independently of Section 234 (a) (8), when the two can only be intelligently construed together. It thus violated a cardinal rule of construction that a statute is to be construed as a whole so as to give a reasonable effect to all of its provisions. *Ginsberg & Sons* v. *Popkin,* 285 U.S. 204, 208; *Helvering* v. *New York Trust Co.,* No. 873, October Term, 1933, decided May 28, 1934.

We submit that the construction for which we contend is not inconsistent with the express language employed in Section 204 (c) (2). But even if a literal construction would compel the interpretation made by the court below, it should not be followed when to do so makes it impossible to give

effect to the probable intent of Congress as expressed in the statute as a whole. *Helvering* v. *New York Trust Co., supra; Rockford Life Insurance Co.* v. *Helvering,* No. 722, October Term, 1933, decided May 21, 1934.

The court below treated as significant the fact that in enacting Section 114 (b) (3) of the Revenue Act of 1932, which is analogous to Section 204 (c) (2) of the Revenue Act of 1926, here involved, Congress qualified the term "gross income from the property" by the clause "excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property" and thus adopted the construction for which we are contending. But the committee report relating to this change (see H. Conference Rep. 1492, 72d Cong., 1st Sess., p. 14) states that the amendment "makes it clear" that the exclusion is to be made. This explanation is susceptible of the view that Congress was merely enacting into law the correct interpretation of the existing law. See *Helvering* v. *New York Trust Co., supra.*

CONCLUSION

We submit that the decision of the Circuit Court of Appeals is incorrect, that it conflicts in principle with the decision of the Circuit Court of Appeals for the Tenth Circuit in *Darby-Lynde Co.* v. *Alexander, supra,* that the question involved is one of

general importance, and that the petition for a writ of certiorari should be granted.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
HELEN R. CARLOSS,
Special Assistants to the Attorney General.

JULY 1934.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 204. (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph. (U.S.C.App., Title 26, Sec. 935.)

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions,

vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period. (U.S.C.App., Title 26, Sec. 954.)

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee. (U.S.C.App., Title 26, Sec. 955.)

SEC. 233. (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross in-

come as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. (U.S.C. App., Title 26, Sec. 985.)

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee. (U.S.C.App., Title 26, Sec. 986.)

Treasury Regulations 69:

ART. 221. *Depletion in the case of oil and gas wells.*—Under section 204 (c) (2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property.

In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 204 (c) (2) and this article, refers to the separate tracts or leases of the taxpayer.

U. S. GOVERNMENT PRINTING OFFICE: 1934

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 170

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

TWIN BELL OIL SYNDICATE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 14–27) is reported in 26 B. T. A. 172. The opinion of the Circuit Court of Appeals (R. 194–214) is reported in 70 F. (2d) 402.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 12, 1934 (R. 215). The petition for a writ of certiorari was filed July 12, 1934, and

was granted October 8, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether an assignee of an oil lease is entitled to the full depletion allowance of 27½ percent of gross income from the leased wells or whether such allowance must be equitably apportioned among the lessor, lessee, and assignee.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved are set forth in the Appendix, *infra,* pp. 22–25.

STATEMENT

The facts as found by the Board of Tax Appeals R. 15–20) and as stipulated in part (R. 84–168) by the parties are as follows:

The taxpayer is a California syndicate organized in 1922 for the purpose of acquiring a certain oil and gas lease and operating it (R. 36–41). Both the Board and the court below have held that the syndicate is to be treated as a corporation for Federal income-tax purposes.

The original lessee of the properties was one F. A. Andrews, who secured a twenty-year lease from the owner, W. O. Batson, in December 1921. In addition to certain monthly rentals to be paid until drilling should commence the lessee agreed to

pay as rental or royalty for the land "one-sixth (⅙) of all oil produced and saved therefrom, said payment to be made in money or in kind at the Lessor's option" (R. 86–90).

On February 10, 1922, Andrews assigned all of his right, title, and interest in the lease to Thomas H. Lipps, who agreed to perform all of the covenants of Andrews and that in addition to the one-sixth royalty agreed to be paid to the lessors he would pay to Andrews "one-twelfth ($^{1}/_{12}$) of all petroleum, oil, gas, and other oil products, and casing-head gasoline, produced and saved from each and all wells" on the property either in cash or in kind (R. 95–97).

On April 25, 1922, Lipps assigned all his right, title, and interest in the lease to the trustees of the syndicate, who agreed to comply with all of the terms and conditions of the original lease and also of the assignment by Andrews (R. 103–105).

The one-sixth royalty and the one-twelfth royalty paid to Andrews during the taxable years 1925, 1926, and 1927 were as follows (R. 18):

Year	Batson Royalties	Andrews Royalties
1925	$159,853.20	$79,926.60
1926	143,253.02	71,626.51
1927	70,946.34	35,473.17

In the audit of the taxpayer's returns for 1925, 1926, and 1927, the Commissioner held that the above-mentioned royalties should be deducted from

the gross income from the wells before computing the 27½-percent deduction for depletion allowed under Section 204 (c) (2) (R. 18–19). The Commissioner determined deficiencies as the result of this and other adjustments, and the taxpayer appealed to the Board.

The Board sustained the Commissioner's allowance for depletion, but decided against the Commissioner on another issue. Both parties appealed. The Circuit Court of Appeals for the Ninth Circuit reversed the Board on the issue concerning depletion, which was one of two issues in the syndicate's appeal. That court held that the 27½-percent deduction should be computed on the gross income of the syndicate without deduction for the rents and royalties. The other issues involved in the case were decided for the Government and are not here involved.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the term "gross income from the property" as used in Section 204 (c) (2) of the Revenue Act of 1926, *infra,* means gross income of the taxpayer as defined in Section 213 (a) of that Act, *infra.*

2. In holding that Section 204 (c) (2) should be construed independently of Section 234 (a) (8).

3. In holding that in the case of an assignee paying rents and royalties to its assignor and

the lessor the term "gross income from the property" in Section 204 (c) (2) means gross income including such rents and royalties.

4. In failing to hold that the "gross income from the property" on which the percentage deduction for depletion is based under Section 204 (c) (2) means gross income less rents and royalties.

SUMMARY OF ARGUMENT

Section 234 (a) (8) of the Revenue Act of 1926, which provides for depletion deduction, and Section 204 (c) (2), which prescribes the rate or measure of the allowance, are to be read *in pari materia,* and Section 204 (c) (2) must be construed in the light of the mandate of Section 234 (a) (8) that depletion must be equitably apportioned between lessor and lessee. The only way to give effect to the apportionment provision is to allow the lessor 27½ percent on his share of the total production from the well, and the lessee 27½ percent on his share.

Under the construction adopted by the court below the various parties having an interest in the properties together are allowed deductions equal to 27½ percent of five-fourths of the gross income of the properties or a greater allowance for depletion than the owner himself would be entitled to if he operated the property. Moreover, the court's construction permits the taxpayer to measure his depletion allowance on another's income, and has

the effect of allowing the taxpayer a double deduction. Congress clearly did not intend such results.

The legislative history of Section 204 (c) (2) does not disclose any intention on the part of Congress to do away with the requirement of apportionment between lessor and lessee in the case of percentage deduction. Further, the clarifying provisions in the 1934 Act make it clear that Congress never intended that a lessee's depletion allowance should be based on rents or royalties paid by him in respect to the property.

ARGUMENT

In the present case the taxpayer was a sublessee of certain oil properties. It received the total income from the sale of the oil and gas produced but was obligated to pay the lessor one-sixth and its assignor one-twelfth, a total of one-fourth of the production. In computing the taxpayer's taxable net income the Commissioner allowed as a depletion deduction 27½ percent of the taxpayer's share of the oil produced; that is, 27½ percent of three-fourths of the production. The court below, however, allowed 27½ percent of the entire production, despite the fact that the taxpayer was entitled under Section 234 (a) (1) of the Revenue Act of 1926 (*infra*, p. 23) to deduct from its gross income the royalty payments, and also despite the fact that those to whom the taxpayer made royalty payments were likewise entitled to a 27½ percent depletion allowance on the royalties paid to them. In this we submit the court clearly erred.

It is fundamental, of course, that deductions from gross income are purely matters of legislative grace, and a taxpayer is entitled to no deduction unless the statute plainly authorizes it. The deduction for depletion in the case of corporations [1] is set forth in Section 234 (a) (8) of the Revenue Act of 1926 (*infra,* p. 24) which provides that a deduction shall be allowed:

> In the case of mines, oil and gas wells * * * for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. *In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee.*[2] (Italics supplied.)

Section 204 (c) (*infra,* p. 22) provides that the basis upon which depletion is to be allowed is the same as that provided in the case of a sale, with certain exceptions. One of these exceptions is set forth under subdivision (2), upon which the court relied entirely for its conclusion, as follows:

> In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property dur-

[1] The taxpayer is an association taxable as a corporation.

[2] Section 214 (a) (9) (*infra,* p. 23) grants an allowance under similar conditions to individuals.

> ing the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

It is apparent that the authority for the depletion deduction is contained only in Section 234 (a) (8). Section 204 (c) (2) merely provides the rate or measure of the allowance in those cases falling within Section 234 (a) (8). Section 204 (c) (2) is dependent for its operation upon Section 234 (a) (8). It is necessary, therefore, to read the two sections together so as to give a reasonable effect to both provisions. *Ginsberg & Sons* v. *Popkin*, 285 U. S. 204, 208; *Helvering* v. *New York Trust Co.*, 292 U. S. 455. And Section 204 (c) (2) must be construed in the light of the mandate of Section 234 (a) (8) that depletion must be equitably apportioned between lessor and lessee. So construed, it seems reasonably clear that Congress intended that the reasonable allowance for depletion in the case of oil and gas wells on leased property should be 27½ percent of the gross income "from the property", and that this allowance should be equitably apportioned between the lessor and lessee. The taxpayer, as lessee, had a three-fourths interest in the oil produced from the well, the other one-fourth interest being in Batson, the lessor, and Andrews, the original lessee. The depletion allow-

ance with respect to the oil and gas wells should be 27½ percent of the gross income from the wells equitably apportioned between the taxpayer, Batson, and Andrews.

The court below reached its conclusion by considering Section 204 (c) alone and construed the words "gross income from the property" as used in that subsection as meaning the taxpayer's gross income as defined in Section 213 of the Act (*infra*, p. 22). But in this the court plainly erred. Clearly the words "gross income from the property", as employed in Section 204 (c) (2), did not include income from other businesses separate and distinct from the operations of the oil properties themselves. In *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 461, this Court referred to the percentage depletion provision as follows:

> But the "discovery value" provision was eliminated from the act of 1926, which is applicable here, and the taxpayer was permitted to calculate depletion on the basis of cost alone, Sec. 204 (c), or else to deduct an arbitrary allowance, fixed by the statute, without reference to cost or discovery value, at 27½ percent of *gross income from the well.* [Italics supplied.]

In *Darby-Lynde Co.* v. *Alexander*, 51 F. (2d) 56 (C. C. A. 10th), certiorari denied, 284 U. S. 666, the taxpayer argued that the proceeds from the sale of the oil property itself (in addition to the proceeds from the sale of oil and gas) constituted gross income and should be included in the gross income on

which the percentage depletion deduction was based. But the court rejected that argument, holding that the term "gross income from the property" as employed in Section 204 (c) (2) meant gross income from production. See also *Macon Oil & Gas Co.* v. *Commissioner,* 23 B. T. A. 54; *Fritz* v. *Commissioner,* 28 B. T. A. 408. Compare also *Houston Production Co.* v. *United States,* 4 F. Supp. 715 (S. D. Tex.); G. C. M. 2315, VI–2 Cumulative Bulletin 21. It is clear, therefore, that "gross income from the property" refers to something other than the taxpayer's statutory gross income.

It is to be observed in this connection that Section 204 (c) (2) provides first for a depletion allowance of "27½ per centum of the gross income from the property", and second that "such allowance shall not exceed 50 per centum of the net income *of the taxpayer* (computed without allowance for depletion) from the property." (Italics supplied.) We think the choice of language here is significant. The allowance in the first clause of the paragraph is based on the "gross income from the property", while the limitation in the second clause is fixed at 50 percent of "the net income *of the taxpayer* * * * from the property." The omission of the phrase "of the taxpayer" in the first clause and the insertion of those words in the second is susceptible of the interpretation that in the first Congress was dealing with gross income produced by the property irrespective of whether technically it was the taxpayer's gross income, or that of his

lessor, or both combined, while in the second, Congress was dealing with the net income of the particular taxpayer. In other words, Congress intended to allow for depletion a flat 27½ percent of the total income produced by the well, irrespective of to whom this income was attributable; that in the case of leases this total allowance is to be apportioned equitably between the lessor and lessee, but in no event is the allowance to be greater than 50 percent of the taxpayer's net income. This is the construction placed upon the phrase "gross income from the property" by the Board of Tax Appeals in the instant case (R. 24–25), and in *Greensboro Gas Co.* v. *Commissioner,* 30 B.T.A. 1361.

But whether those words are to be construed as meaning gross production from the property, as held by the Board, or the taxpayer's gross income from the property, they must still be read in the light of the equitable apportionment provision in Section 234 (a) (8). The Commissioner solved the problem of apportionment in the present case by holding that the phrase "gross income from the property" meant the gross income from production less the amounts which the taxpayer was obliged to pay to his assignor and to the lessor, that is, three-fourths of the total. In that way the taxpayer was allowed 27½ percent of the gross income from production, which it was permitted to retain, and his assignor and the lessor together would receive an allowance based upon 27½ percent of the

remaining one-fourth.[3] This was clearly a reasonable construction of the two sections when read together. See *Night Hawk Leasing Co.* v. *Burnet,* 57 F. (2d) 612 (App. D. C.).

It is a cardinal rule of statutory construction that when the language of a statute is of doubtful meaning, or when adherence to the strict letter would lead to injustice or absurdity, or result in contradictory provisions, it devolves upon the court to ascertain the true meaning. If possible, the statute will be construed so as to avoid inequity and to achieve a reasonable result. *United States* v. *Katz,* 271 U. S. 354, 357; *In re Chapman,* 166 U. S. 661; *United States* v. *Kirby,* 7 Wall. 482, 486–487. The construction placed on Section 204 (c) (2) by the court below violates these principles.

Obviously the lessor and the taxpayer's assignor have an economic interest in the property and are entitled to a deduction for depletion based on 27½ percent of the one-fourth royalty that they together received. *Palmer* v. *Bender,* 287 U. S. 551; *Helvering* v. *Falk,* 291 U. S. 183; *Green* v. *Commissioner,* 26 B. T. A. 1017. But under the construction of the statute by the court below the taxpayer, the lessor, and the assignor together would be allowed a deduction equal to 27½ percent of five-fourths of

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[3] As pointed out by the Board (R. 25), the allowance determined by the Commissioner is exactly the same as would have been determined had the Commissioner taken 27½ percent of the total gross income from the property and apportioned three-fourths of the amount to the taxpayer.

the gross income from the property. It is unreasonable to suppose that Congress intended that a multiplication of interests in the property should result in a greater allowance for depletion than the owner himself would be allowed if he operated the property.[4] It is far more reasonable to assume that Congress intended that the percentage deduction allowable to all having an economic interest should amount in the aggregate to 27½ percent of the gross income from the property, that is, from production, and that this amount should be equitably apportioned between all having such interest. There is no apportionment under any other theory.

Moreover, it is unreasonable to suppose that Congress intended that a taxpayer should measure his depletion allowance by another's interest in the property. Yet the decision below has that result. The fundamental purpose of the depletion statutes has always been to return to a taxpayer, whatever

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[4] The discussions before the Senate Finance Committee, where the amendment which ultimately became Section 204 (c) (2) originated, indicate that the framers of this legislation had in mind the abolition of discovery depletion and the substitution of a flat percentage based on gross production from the operation of the properties. See Hearings before the Committee on Finance on H. R. 1, 69th Cong., 1st Sess., pp. 147, *et seq.*, particularly at pp. 152–158, 178–179, 180. The discussions dealt only with the case of an operating owner, but in basing the percentage allowance on gross production, the Committee clearly did not intend in the case of leases that the total allowance to lessor and lessee should exceed the 27½ percent allowed to the operating owner.

his interest may be, a reasonable allowance for the exhaustion *of his interest* in the property caused by the depletion of the natural resource during the taxable year. *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364; *Palmer* v. *Bender, supra; Night Hawk Leasing Co.* v. *Burnet, supra.* The insertion of the percentage depletion provision in the 1926 Act wrought no change in this fundamental purpose. The provision was inserted merely to put an end to the difficulties occasioned by the computation of depletion on the basis of discovery value in the case of oil and gas wells. S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18; H. Rep. No. 356, 69th Cong., 1st Sess., pp. 31–32. Congress, in the 1926 Act, did not intend to break with the past and narrow the functions of the depletion allowance. The real nature and purpose of the depletion provisions remained unchanged. *United States* v. *Dakota-Montana Oil Co., supra.* In permitting the taxpayer here to take depletion based on royalties paid over to the lessor and its assignor the court below has allowed the taxpayer depletion based on another's interest in the depletable asset and without regard to the taxpayer's interest in the property, thus violating the fundamental purpose of the depletion statutes. We submit Congress never intended that the percentage depletion provisions should have that effect.

It may be true that the portion of the income from the property which the taxpayer pays over in the form of royalties to its assignor and the original

lessor is required to be reported in its gross income in its return (*Comar Oil Co.* v. *Burnet,* 64 F. (2d) 965 (C. C. A. 8th), certiorari denied, 290 U. S. 652), but these royalties did not represent an exhaustion of the taxpayer's interest in the oil reserve for which it should have a depletion allowance. In many cases the pipe-line company or other purchaser of the oil production recognizes the different economic interests in the oil properties and as a matter of practice instead of paying the operating lessee the full price paid for the entire production, pursuant to a division order, make payments directly to the various interested parties in accordance with their several economic interests; so that in those cases a taxpayer like the one here would receive payment for only three-fourths of the oil produced and the assignor and the lessor together would receive directly from the purchaser payment for the remaining one-fourth. The practice in those cases is for the operating lessee to report in his gross income only the payments actually received by him, and for the others in interest to report the amounts received by them. This practice has been recognized and approved by the Treasury Department. Thus the question presented in this case can not arise in many cases because the taxpayer's "gross income from production" usually includes only the fraction of production which, under the lease, the lessee is permitted to retain, excluding royalties paid directly to the lessor or others in interest. It

so happened that in this case the lessee received payment for the entire production and was required to make disbursements to its assignor and to the lessor. In other words, it acted as a collecting agent for the lessor and its assignor, a conduit through which the royalty payments passed. And, unlike the *Comar* case, the taxpayer here was permitted to deduct under Section 234 (a)(1) of the Act, *infra*, p. 23, the current royalties paid over by it in the form of rent.[5] The effect is the same as if it had included in its gross income only three-fourths of the total production from the wells, as is the practice in the cases above referred to. We submit that Congress never intended that a taxpayer in a situation like this, who receives royalties for the benefit of another, who is obligated to pay such royalties immediately over to those entitled thereto, and who

[5] While the record does not affirmatively show that this taxpayer deducted royalties paid by it under Section 234 (a) (1), in its petition to the Board it asserted that it was entitled to such deductions (R. 6) and we are advised by the Treasury that as a matter of fact such deductions were claimed on the several tax returns and were allowed by the Commissioner. This case differs from the *Comar* case in that here the royalties were payable currently from production over the life of the lease and were considered by both the taxpayer and the Commissioner as in the nature of current rental payments; whereas in the *Comar* case the royalties involved were payable out of the first runs of oil and gas, and since the benefits of such payments extended beyond the current year, they were more in the nature of capital expenditures and not deductible under Section 234 (a) (1).

deducts such payments from its gross income, should have a greater depletion allowance than the lessee in the case where payments are made directly by the pipe-line company or other purchaser. To permit the taxpayer here to deduct royalty payments in determining its taxable income, and at the same time to include such royalties for the purpose of determining its depletion allowance, is in effect to allow a double deduction, a result clearly not intended by Congress.

Our interpretation of the statute results in no undue hardship to the taxpayer. Section 204 (c) (2) provides that in no case shall the percentage allowance be less than it would be if computed without reference to that paragraph. Under this provision the taxpayer is always permitted to have his depletion computed on the basis of cost if the computation under that method results in a greater deduction. Thus the taxpayer is always assured of having a return of his capital, and our construction of the statute works no hardship on him, whereas the court's construction achieves an unreasonable result.

That our construction is the proper one is demonstrated, we submit, when we consider the legislative history of the provisions involved. The legislative history of Section 204 (c) (2) does not disclose any intention on the part of Congress to do away with the requirements of apportionment between the

lessor and lessee in the case of the percentage deduction. As stated above, the provision was inserted merely to put an end to the difficulties occasioned by the computation of depletion based on discovery value. S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18; H. Rep. No. 356, 69th Cong., 1st Sess., pp. 31–32. Thus we must continue to apply the equitable apportionment requirements and construe that provision in conjunction with Section 204 (c) (2). See also footnote 4, p. 13, *supra.*

Section 204 (c) (2) of the 1926 Act was reenacted in identically the same language as Section 114 (b) (3) of the Revenue Act of 1928. The Commissioner construed both of these sections as requiring the exclusion from the gross income of rents and royalties in computing the 27½ percent deduction for depletion under both the 1926 and 1928 Acts. See *Greensboro Gas Co.* v. *Commissioner, supra.* Thereafter, the same provisions were reenacted as Section 114 (b) (3) of the Revenue Act of 1932, p. 24, *infra,* with an amendment which added the words "excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property." Thus Congress incorporated in the 1932 Act the prior practice of the Commissioner and that Act is entirely in accord with the position taken by us here. The legislative history of the 1932 amendment indicates that the purpose of the amendment

was to clarify the existing law, not to change it. The amendment in question originated in the Senate and was offered under the following circumstances (Cong. Record, Vol. 75, Part 10, pp. 11629, 11630):

> Mr. SMOOT. * * * I may also say that I have 10 or 11 other amendments of a *clarifying* nature which I want to offer following the one now offered.
>
> * * * * *
>
> Mr. KING. I think my colleague should state that the amendments which he is about to offer were all presented to the committee, considered by the committee, and unanimously agreed to by it.
>
> * * * * *
>
> Mr. SMOOT. Yes; and they were all prepared by the Treasury Department.

The amendment to Section 114 (b) (3), No. 53, was one of the clarifying amendments so offered by Mr. Smoot and was adopted by the Senate. In conference the amendment was accepted by the House and in its conference report it was stated (H. Conference Rep. No. 1492, 72d Cong., 1st Sess., p. 14):

> This amendment *makes it clear* that in computing the gross income from the property, for the purpose of determining the allowance for percentage depletion in the case of oil and gas wells, there shall be excluded from such gross income an amount

> equal to any rents or royalties paid or incurred by the taxpayer in respect of the property * * *. [Italics supplied.]

We submit that this amendment is declaratory of existing law, and was intended to clarify rather than to alter the provisions of the previous Act. Congress was merely enacting into law the correct interpretation of the existing law. See *Luckenbach S. S. Co.* v. *United States,* 280 U. S. 173, 182–183; *Commissioner* v. *Liberty Nat. Co.,* 58 F. (2d) 57 (C. C. A. 10th); *Helvering* v. *New York Trust Co., supra.*

We submit that the court below reached a result opposed to the clear intent of Congress by construing Section 204 (c) (2) independently of Section 234 (a) (8), when the two can only be intelligently construed together. It thus violated the fundamental principle of statutory construction above adverted to—that a statute is to be construed as a whole so as to give a reasonable effect to all its provisions. The construction for which we contend is not inconsistent with the express language employed in Section 204 (c) (2). But even if the literal language would compel the interpretation made by the court below, it should not be followed when to do so makes it impossible to give effect to the probable intent of Congress as expressed in the statute as a whole. *Helvering* v. *New York Trust Co., supra; Rockford Life Insurance Co.* v. *Helvering,* 292 U. S. 382.

CONCLUSION

The decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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OCTOBER 1934.

APPENDIX

REVENUE ACT OF 1926, C. 27, 44 STAT. 9

SEC. 204. (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph. [U. S. C. App., Title 26, Sec. 935.]

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership

or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period. [U. S. C. App., Title 26, Sec. 954.]

* * * * *

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee; [U. S. C. App., Title 26, Sec. 955.]

* * * * *

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including

rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

* * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee [U. S. C. App., Title 26, Sec. 986].

* * * * *

REVENUE ACT OF 1932, C. 209, 47 STAT. 169

SEC. 114. * * *

(b) Basis for Depletion—

(3) Percentage depletion for oil and gas wells.—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph (U. S. C. Sup. VII, Title 26, Sec. 114.)

* * * * *

ART. 221. *Depletion in the case of oil and gas wells.*—Under section 204 (c) (2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ percent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property", as the term is used in section 204 (c) (2) and this article, refers to the separate tracts or leases of the taxpayer.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1934.

No. 170.

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

Twin Bell Oil Syndicate,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

Opinions Below.

The opinion of the Board of Tax Appeals [R. 14-27] is reported in 26 B. T. A. 172. The opinion of the Circuit Court of Appeals [R. 192-214] is reported in 70 F. (2d) 402.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 12, 1934. [R. 215.] The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Whether, in determining the gross income for the purpose of applying the provisions of Section 204(c) (2) of the Revenue Act of 1926, which provides for a deduction for depletion based on 27½ per cent of gross income, the taxpayer's actual gross income should be reduced by rentals and royalties paid.

Statutes Involved.

The statutes and regulations involved are contained in the Appendix hereto.

STATEMENT.

The facts as found by the Board and as stipulated (in part) by the parties are as follows:

The taxpayers is a California syndicate organized in 1922 for the purpose of acquiring a certain oil and gas lease and operating it. [R. 36-41.] Both the Board and the court below have held that the syndicate is to be treated as a corporation for Federal income-tax purposes.

The original lessee of the properties was one F. A. Andrews, who secured a twenty-year lease from the owner,

W. O. Batson, in December, 1921. In addition to certain monthly rentals to be paid until drilling should commence the lessee agreed to pay as rental or royalty for the land "one-sixth (1-6) of all oil produced and saved therefrom, said payment to be made in money or in kind at the lessor's option." [R. 86-90.]

On February 10, 1922 this lease was assigned by F. A. Andrews to Thomas H. Lipps. The agreement or assignment contained the provision that, in addition to the payment of the one-sixth royalty specified in the original lease, the lessee would pay a one-twelfth royalty to the lessor. [R. 95-97, 197.]

On April 25, 1922, Lipps assigned all his right, title and interest in the lease to the trustees of the syndicate, who agreed to comply with all of the terms and conditions of the original lease and also of the assignment by Andrews. [R. 103-105.]

The taxpayer has never acquired any property other than the lease assigned to it by Lipps and has never sold any part of such lease. The taxpayer had a contract under which it sold all the oil produced to the Associated Oil Company. [R. 42.] The taxpayer entered on its books the payments received from the sale of its oil in an "Oil Runs Account" and charged against such account the royalties paid to Batson and Andrews. [R. 49-50.]

The one-sixth royalty and the one-twelfth royalty paid to Andrews during the taxable years 1925, 1926 and 1927 were as follows [R. 18]:

Year	Batson Royalties	Andrews Royalties
1925	$159,853.20	$79,926.60
1926	143,253.02	71,626.51
1927	70,946.34	35,473.17

In the audit of the taxpayer's returns for 1925, 1926 and 1927, the Commissioner held that the above-mentioned royalties should be deducted from the gross income from the wells before computing the 27½ per cent deduction for depletion allowed under Section 204(c) (2). [R. 18-19.]

The Commissioner determined deficiencies as the result of this adjustment of the depletion allowance and other adjustments and the taxpayer appealed to the United States Board of Tax Appeals.

The Board sustained the Commissioner's allowance for depletion, but decided against the Commissioner on another issue. Both parties appealed. The Circuit Court of Appeals for the Ninth Circuit reversed the Board on the issue concerning depletion, which was one of two issues in the taxpayer's appeal . The Circuit Court held that the 27½ per cent deduction should be computed on the gross income of the taxpayer without deduction for the rents and royalties. The other issues involved in the case were decided for the Government and are not here involved.

ARGUMENT.

The Decision in This Case Is Not in Conflict With Any Decision of Any Other Circuit Court of Appeals Relating to the Same Matter.

In his brief, petitioner contends that the decision of the Circuit Court in this cause is in conflict in principle with the decision of the Circuit Court of Appeals for the Tenth Circuit in the case of *Darby-Lynde Co. v. Alexander*, 511 Fed. (2d) 56, *certiorari* denied, 284 U. S. 666. The issue in the *Darby-Lynde Co.* case was the question of whether income realized from the sale of oil properties should be considered as gross income upon which the depletion allowance might be based. The issue, therefore, did not involve the same matter as is involved in the instant proceeding. However, in reaching a conclusion in that case, the Court, in its Opinion, reviewed the law concerning the depletion allowance. Although the petitioner interprets the Court's decision as being in conflict with the decision of the Circuit Court in this Twin Bell Oil Syndicate case, we respectfully submit that the Court's decision is not only *not* in conflict but actually supports the Opinion of the Court in the instant case, and in support of our conclusion we respectfully call attention to that part of the Court's Opinion in the *Darby-Lynde Co.* case which reads as follows, 51 Fed. (2d) 56, on page 59:

> "In order to reach a reasonable and rational result, *the words 'gross income' as used* in sec. 204(c)(2) *must be construed as meaning the gross income produced from the operation of such oil and gas wells.* The language is clearly susceptible of the construction that it is income from or out of the property itself; not out of its sale.

"The legislative history of the 1926 act confirms this view. In the Revenue Acts of 1921 and 1924, in cases of oil and gas wells, Congress had provided, with certain limitations, for a depletion allowance based upon discovery value. See section 214(a) (10) and section 234(a) (9), Revenue Act of 1921 (42 Stat. 241, 256) and section 204(c), Revenue Act of 1924 (26 USCA § 935 note). When Congress wrote the provision for depletion allowance in the case of oil and gas wells in the Revenue Act of 1926, it departed from the discovery value basis because of the difficulty of administration. The discussions before the Senate Finance Committee, where the amendment which ultimately became section 204(c) (2), 26 USCA § 935 (c) (2) originated, discloses that the framers of this legislation had in mind operating income as distinguished from income derived from sales. See report of hearings before that committee, pages 153, 154, 177 and 179.

"We conclude that the words 'gross income,' as used in section 204 (c) (2), supra, mean income derived from the sale or other disposition of oil and gas produced, and not from the sale of the oil and gas properties." (Italics ours.)

In the instant proceeding the Circuit Court for the Ninth Circuit concluded that the term "gross income," as used in Section 204(c) (2), must be construed as the income derived from the sale or other disposition of oil and gas produced, and in this conclusion the decision of the Court is entirely consistent with the decision in the *Darby-Lynde Co.* case.

The only other decision which is at all related to the issue involved in this proceeding is the decision of the

United States Circuit Court of Appeals for the Eighth Circuit in the case of *Comar Oil Company v. Burnet*, 64 Fed. (2d) 965, 967-968, *certiorari* denied, 78 Law Ed. 76, October 9, 1933. That case did not involve the exact issue which is involved in this proceeding but the Government did raise the contention in that case, as in this case, that the amount of the royalties paid by a lessee to a lessor should not be considered part of the income of the lessee. The Circuit Court, in ruling upon this contention, used the following language:

> "It will be apparent upon examination of the statute (section 213(a)) that the term 'gross income' is broad in scope; broad enough to include, in the case of a lessor, rents or royalties paid to him by the lessee (cases cited); *broad enough also to include, in the case of a lessee, rents or royalties paid by him to the lessor owner; and the practice has been to include them as gross income in the return.* (Cases cited.)
>
> "It is one of the contentions of petitioners that these overriding royalties should be treated in the same manner as the original royalties. We think this contention is sound in so far as it results in the inclusion of both the original royalties and the overriding royalties in the category of 'gross income.'
>
> "We are not insensible to the forceful argument of petitioner that neither original royalties nor overriding royalties should be included in gross income of the lessee, sublessee, or transferee. The argument is one, however, which we think should more properly be presented to the Congress than to the courts. The inclusion of royalties in the gross income of the lessee not only finds support in the language of

sections 233 and 213 of the Revenue Act of 1921 but also in the actual practice as established during a considerable number of years."

From the above it is apparent that the decisions at present are without conflict in the conclusion that for depletion purposes the term "gross income" includes the income derived from the sale of oil and gas produced, which includes the amounts of rents or royalties paid by a lessee to a lessor.

The Decision of the Circuit Court Is In Conformity With the Unambiguous Terms of the Statute.

The provision of the Revenue Act of 1926 relating to the percentage depletion allowance reads as follows:

Section 204(c) (2)—

> "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

The Commissioner's contention is, in effect, that the lessee's "gross income" is the proceeds from the sale of oil and gas produced, reduced by the amount of royalties which the lessee pays, out of these proceeds, to the lessor. There is no authority for such a conclusion.

The law is well established that royalties paid by a lessee to a lessor constitute rental payments for the use of property and, for income tax purposes, represent income to the lessor who receives them, and deductions to the lessee who pays them. (*Von Baumbach v. Sargent Land Co.*, 242 U. S. 503; *U. S. v. Biwabik Mining Co.*, 247 U. S. 116; *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364; *Burnet v. Harmel*, 287 U. S. 103; *Bogle & Co.*, 5 B. T. A. 541, 552.)

The gross income to the lessee is the total proceeds derived from the sale of oil and gas produced. (*Darby-Lynde Co., supra; Comar Oil Co., supra.*) From this gross income the lessee deducts royalties paid, as one of the deductions to be taken from gross income to arrive at the net income. (Sec. 213, 214, 212, 233, 234, 232, Revenue Act of 1926—*Bogle & Co. v. Commissioner, supra.*)

This is exactly the manner in which the taxpayer, the Twin Bell Oil Syndicate, treated the proceeds from the sale of its oil and gas and the royalties paid on its books and records, as set out in the preceding STATEMENT.

Section 204(c) (2) above quoted prescribes that the arbitrary percentage depletion allowance shall be "27½ per centum of the gross income." Whether this section is read alone or in conjunction with any or all other provisions of the Revenue Act of 1926 (*Ginsberg & Sons v. Popkin*, 285 U. S. 204), its terms are so plain and definite that they cannot be said to be ambiguous, and they cannot

be given any other meaning than that clearly imparted by the words used.

The very interpretation contended for by the Commissioner refutes his argument that the statute supports such a contention. In other words, to sustain the Commissioner's interpretation, Section 204(c) (2) must be construed to read:

> "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year" *excluding from such gross income an amount equal to any rents or royalties.*

To construe a statute in such a manner as to require an addition of a specific exception or exclusion clause, to exclude something controlled by the plain and general terms of the statute, is like substituting a negative for an affirmative provision of a statute. There is no rule of statutory construction which would permit of such an interpretation of a statute. Statutes are not to be extended by implication beyond the clear import of the language used, or enlarged so as to embrace matters not specifically pointed out. (*Gould v. Gould,* 245 U. S. 151.)

From a study of the statute the conclusion is inevitable that for depletion purposes the gross income must include the total proceeds received from the sale of oil and gas produced from taxpayer's property and cannot be reduced by amounts of royalties paid for the use of the property.

The Change in the Revenue Act of 1932 Regarding the Percentage Depletion Allowance Is New Law and Has No Retrospective Effect.

The change in terminology in Section 114(b) (3) of the Revenue Act of 1932, which corresponds to Section 204(c) (2) of the Revenue Act of 1926 and Section 114(b) (3) of the Revenue Act of 1924, shows very clearly the force of the lower court's decision in this proceeding. Section 114(b) (3) of the Revenue Act of 1932 reads as follows:

> "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, *excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect to the property.*"

The portion in italics is a new provision not contained in the earlier acts. Since it is a provision for exclusion of matter otherwise included in the general language of the rest of the sub-section, it must be construed as an amendment of the old law, and it is indicative of the appreciation by Congress of the effect of the section as it was constructed in the earlier Revenue Acts. The added provision in the above section might well be considered a legislative recognition that under the prior acts the gross income was not to be adjusted by the exclusion of royalties paid. The change in this section is too significant a

change of phraseology, and too much alters the ordinary meaning of the section as it was constructed in the earlier Revenue Acts, to support any contention that the amendment should be considered a clarification of the section as it was contained in the earlier Revenue Acts. (*Hecht v. Malley*, 265 U. S. 144, 156.) Where such a significant change exists as to result in a different meaning than could be assignable to the words used in the prior statute, the amended statute will be deemed to be an enactment of new law, establishing rules for the future, and will not be applied retrospectively. (*U. S. v. Magnolia Petroleum Company*, 276 U. S. 160, 162; *Brewster v. Gage*, 280 U. S. 327; *Russell v. U. S.*, 278 U. S. 181.)

In this connection, even if there should be any doubt as to the interpretation of the provisions of this statute (Section 204(c) (2)), or as to the connotation of the terms used, and another meaning might be adopted, the fact of their use in a tax statute would incline the scale to the construction most favorable to the taxpayer. (*Gould v. Gould, supra; U. S. v. Updike*, 281 U. S. 489; *Burnet v. Niagara Falls Brewing Co.*, 282 U. S. 648.)

CONCLUSION.

We respectfully submit that the provisions of Section 204(c) (2) of the Revenue Act of 1926 are clear and unambiguous and are correctly interpreted by the court below in its decision in this case. The precise question is not at this time of general importance since it arises only in the tax computations of those taxpayers engaged in the production of oil and gas and affects only the years controlled by the Revenue Acts of 1926 and 1928, and there is no conflict of decisions which requires review. The petition should be denied.

Respectfully submitted,

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APPENDIX.

Statutes Involved.

REVENUE ACT OF 1926:

Section 204(a).

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—"

Section 204(b).

"The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property (or, in the case of such property as is described in paragraph (1), (4), or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date."

Section 204(c).

"The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—"

Section 204(c) (2).

"In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph." (Section 114(b) (3) of the Revenue Act of 1928 contains the same provision of Section 204(c) (2) of the Revenue Act of 1926 above quoted.)

REVENUE ACT OF 1932:

Section 114(b) (3).

"*Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

REVENUE ACT OF 1926:

Section 212(a) (232(a)).

"In the case of an individual the term 'net income' means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206."

Section 233(a).

"In the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217 . . ."

Section 213.

"For the purposes of this title, except as otherwise provided in section 233—

(a) The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivisions (b) of section 212, any such amounts are to be properly accounted for as of a different period."

Section 214(a) (and 234(a) (1)).

"In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity; . . ."

Section 214(a) (9) (and Sec. 234(a) (88)).

"In computing net income there shall be allowed as deductions:

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; . . ."

REVENUE ACT OF 1932:

Section 23 (1).

"*Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. . . ."

REGULATIONS 69:

Article 221.

"Under Section 204(c) (2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or the value at the basic date, as the case may be . . ."

Article 203.

"Amount returnable through depletion and depreciation deductions in the case of lessee.—(a) In the case of a lessee, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity in the property plus (2) subsequent allowable capital additions and minus (3) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, and minus (4) the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation. The provisions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

(b) The values of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(c) The value of a lessee's equity, if acquired prior to March 1, 1913, is to be taken to mean (1) its cost or (2) the value of his interest in the mineral as of that date, whichever is greater.

(d) The value of a lessee's equity in a proven mineral property acquired on or after March 1, 1913, is to be taken to mean its cost.

(e) The value of a lessee's equity in a discovery after February 28, 1913, is the fair market value at date of

discovery, or within 30 days thereafter, of his equity in the mineral discovered."

Article 204.

"*Amount returnable through depletion and depreciation deductions in the case of lessor.*—(a) In the case of a lessor, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value of his equity in the property at the basic date minus (2) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, plus (3) subsequent allowable capital additions, and minus (4) the value of the land at the basic date for other purposes than mineral production and the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation. The provisions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

(b) The values of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(c) The value of the lessor's equity in the case of a mineral property not under lease on March 1, 1913, but subsequently leased, is to be taken to mean (1) the cost or (2) the *en bloc* value of the mineral in the ground on March 1, 1913, whichever is greater, and will, in the absence of satisfactory evidence to the contrary, be pre-

sumed not to exceed the value as of March 1, 1913, of the royalties to be expected under the lease.

(d) The value of a lessor's equity in a mineral property under lease March 1, 1913, for the entire operating life of the mineral deposits is to be taken to mean (1) the cost of (2) the value as of March 1, 1913, of the royalties and other payments to be expected under the terms of the lease in effect on that date, whichever is greater.

(e) The value of a lessor's equity in a mineral property under lease March 1, 1913, for a portion of its operating life is to be taken to mean (1) the cost or (2) the value as of March 1, 1913, of the royalties expected from the mineral to be extracted during the life of the existing lease plus the estimated *en bloc* value of the mineral remaining at its expiration, which, in the absence of satisfactory evidence to the contrary, will be presumed not to exceed the value as of March 1, 1913, of royalties which could have been expected as at that date from the remaining mineral.

(f) The value of a lessor's equity in a mineral property when acquired on or after March 1, 1913, is to be taken to mean its cost.

(g) The value of a lessor's equity in a discovery after February 28, 1913, is the fair market value at the date of discovery, or within 30 days thereafter, of his equity in the mineral discovered."

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CHARLES ELMO

IN THE

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OF THE

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OCTOBER TERM, 1934.

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BRIEF FOR THE RESPONDENT.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1934.

No. 170.

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

Twin Bell Oil Syndicate,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINION BELOW.

The findings of fact, opinion and decision of the United States Board of Tax Appeals [R. 14-27] are reported in 26 B. T. A. 172. The opinion of the Circuit Court of Appeals [R. 192-214] is reported in 70 Fed. (2d) 402.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered April 12, 1934 [R. 215]. A petition for certiorari was filed July 12, 1934, and granted October 8, 1934. Jurisdiction is conferred upon this court by section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Whether, in determining the gross income for the purpose of applying the provisions of section 204(c) (2) of the Revenue Act of 1926, which provides for an allowance for depletion based on 27½ per cent of gross income, the taxpayer's actual gross income should be reduced by royalties paid.

STATUTES AND REGULATIONS INVOLVED.

The applicable provisions of the Statutes and Regulations involved are set forth in the Appendix hereto.

STATEMENT.

The taxpayer is a California syndicate organized in 1922 for the purpose of acquiring a certain oil and gas lease and operating it. [R. 36-41.] Both the Board and the court below have held that the syndicate is to be treated as a corporation for Federal income-tax purposes.

The original lessee of the properties was one F. A. Andrews, who secured a twenty-year lease from the owner, W. O. Batson, in December, 1921. In addition to certain monthly rentals to be paid until drilling should commence

the lessee agreed to pay as rental or royalty for the land "one-sixth (1/6) of all oil produced and saved therefrom, said payment to be made in money or in kind at the lessor's option." [R. 86-90.]

On February 10, 1922, this lease was assigned by F. A. Andrews to Thomas H. Lipps. The agreement or assignment contained the provision that, in addition to the payment of the one-sixth royalty specified in the original lease, the lessee would pay a one-twelfth royalty to the assignor. [R. 95-97, 197.]

On April 25, 1922, Lipps assigned all his right, title and interest in the lease to the trustees of the syndicate, who agreed to comply with all of the terms and conditions of the original lease and also of the assignment by Andrews. [R. 104-105.]

The taxpayer has never acquired any property other than the lease assigned to it by Lipps and has never sold any part of such lease. The taxpayer had a contract under which it sold all the oil produced to the Associated Oil Company. [R. 42.] The taxpayer entered on its books the payments received from the sale of its oil in an "Oil Runs Account" and charged against such account the royalties paid to Batson and Andrews. [R. 49-50.]

The one-sixth royalty paid to Batson and the one-twelfth royalty paid to Andrews during the taxable years 1925, 1926 and 1927 were as follows [R. 18]:

Year	Batson Royalties	Andrews Royalties
1925	$159,853.20	$79,926.60
1926	143,253.02	71,626.51
1927	70,946.34	35,473.17

In the audit of the taxpayer's returns for 1925, 1926 and 1927, the Commissioner held that the above-mentioned royalties should be deducted from the gross income from the wells before computing the 27½ per cent deduction for depletion allowed under section 204(c) (2). [R. 18-19.]

The Commissioner determined deficiencies as the result of this adjustment of the depletion allowance and other adjustments and the taxpayer appealed to the United States Board of Tax Appeals.

The Board sustained the Commissioner's allowance for depletion, but decided against the Commissioner on another issue. Both parties appealed. The Circuit Court of Appeals for the Ninth Circuit reversed the Board on the issue concerning depletion, which was one of two issues in the taxpayer's appeal. The Circuit Court held that the 27½ per cent deduction should be computed on the gross income of the taxpayer without deduction for the rents and royalties. The other issues involved in the case were decided for the Government and are not here involved.

SUMMARY OF ARGUMENT.

1. Amounts of royalties paid are part of taxpayer's gross income (*Comar Oil Co. v. Burnett,* 64 Fed. (2d) 965), and, as section 204(c) (2) provides that the depletion allowance shall be 27½ per cent "of the gross income," there is no authority for reducing the gross income upon which the 27½ per cent is to be computed, by royalties paid.

The taxpayer's gross income includes the gross proceeds received from the sale of its oil and gas. (*Darby-Lynde Co. v. Alexander*, 51 Fed. (2d) 56, 59.) That the term "gross income" as used in section 204(c) (2) of the Revenue Act of 1926 is to be so interpreted is impliedly affirmed by the provision of said section when re-enacted as section 114(b) (3) of the Revenue Act of 1932, which latter section provides that the depletion allowance shall be 27½ per cent of the gross income . . ., *"excluding from such gross income* an amount equal to any rents or royalties paid . . .". If the amounts of rents and royalties paid were not part of the gross income before payment of said rents and royalties, there would have been no necessity for the exclusion from gross income clause contained in section 114(b) (3) of the Revenue Act of 1932.

2. Section 204(c) (2) does not provide for a "basis" for depletion but provides for the amount of an "allowance" for depletion to which each taxpayer is entitled, and thereby provides its own "apportionment" of the depletion allowance authorized by it.

It was the intent of the Legislature when section 204(c) (2) was enacted that under such statute, every person having an interest in oil and gas property, whether a legal title or an economic interest (*Palmer v. Bender*, 77 L. Ed. (Adv. Op.) 338), should be entitled to an arbitrary allowance for depletion, thus eliminating the difficulties of administration of a method of computing depletion allowances requiring intricate calculations.

Section 214(a) (9) (or 234(a) (8)) cannot be read as a part of section 204(c) (2) and was not intended as a part of the latter section.

Section 234(a) (8) cannot be applied as a restriction upon the amount of the depletion allowance computable under section 204(c) (2) since the depletion allowance under the latter section is the minimum amount allowable under the statutes.

3. The provision contained in section 234(a) (8) for equitable apportionment of a depletion allowance between lessor and lessee, applies only to the depletion allowance computed under section 234(a) (8).

The provision that the depletion "be equitably apportioned" was not intended to require the distribution of an aggregate depletion allowance to all parties interested in an oil and gas property, but was intended to authorize depletion allowances to lessees. The depletion allowance to lessor and lessee has at all times under Commissioner's regulations been separately computed. (Art. 203 and 204, Reg. 69.)

Section 204(c) (2) being a statute covering a special subject matter, cannot be controlled or modified by the terms of section 234(a) (8) which is general in nature. (*D. Ginsberg & Son v. Popkin,* 285 U. S. 204.)

Under the theory advanced by the Commissioner and the Board of Tax Appeals it must be implied that an exclusion clause is part of section 204(c) (2), to provide for the exclusion of royalties paid from gross income. Since such an exclusion cannot be read or implied in the clear import of the language used in the statute, the Board's construction of the statute violates the rule of statutory construction that the terms of a statute cannot be extended beyond the clear import of the language used. (*Gould v. Gould,* 245 U. S. 151.)

4. Section 114(b) (3) of the Revenue Act of 1932 which contains an amendment of section 204(c) (2), Revenue Act of 1926, and section 114(b) (3) of the Revenue Act of 1928, is a declaration of new law. It repeats the provisions of the two earlier statutes but adds the provision that there should be excluded "from such gross income an amount equal to any rents or royalties paid." The fact that the exclusion clause is new in the Revenue Act of 1932, and excludes a matter clearly included by the general terms of the section without the exclusion clause, is indicative of a declaration of a change in the law under the previous statutes. Ordinarily, statutes establish rules for the future, and they will not be applied retrospectively unless that purpose plainly appears. (*United States v. Magnolia Co.*, 265 U. S. 160, 162; *Brewster v. Gage*, 280 U. S. 327; *Russell v. United States*, 278 U. S.181.) There is nothing in the statute or its legislative history to indicate any purpose that the amendment contained in section 114(b) (3) of the Revenue Act of 1932 should be given retrospective effect.

The amendment in section 114(b) (3) of the Revenue Act of 1932 disproves the Board's theory as to the apportionment of any depletion deduction allowed by section 204(c) (2) of the Revenue Act of 1926. If the Board's theory were applied to section 114(b) (3) of the Revenue Act of 1932, every taxpayer would get a depletion allowance on the basis of gross income from which is excluded royalties paid, regardless of whether he paid any royalty. In other words, under the Board's theory, there must first be computed an aggregate depletion allowance to which all parties interested in the oil and gas wells would get a share, and this computation would be 27½ per cent

of the gross income from which has been excluded the royalties paid, as required by section 114(b) (3). The resulting depletion is then apportioned to lessor and lessee on the basis of their interests under the lease and regardless of what their gross income from the property might be.

This is obviously not the intent of section 114(b) (3). The purpose of the Legislature was to permit each taxpayer, having an interest in an oil and gas property, a depletion allowance of 27½ per cent of his gross income from the property. Congress must have realized at the time the 1932 Act was prepared that because items of royalties paid are included as part of the gross income of the payor, and become gross income to the payee, provision should be made for the exclusion from each respective taxpayer's gross income for the purpose of computing the 27½ per cent deduction, the amount of royalties paid by him, if any, in order to avoid allowing in the future a depletion deduction to several taxpayers on what in effect might be considered the same gross income. The Board's theory of the interpretation of the statute does not give effect to this purpose and creates such an illogical situation that it should not be sustained.

If there is any doubt as to the proper construction of a taxing statute, the doubt should be resolved in favor of the taxpayer, and a construction adopted which is most favorable to the taxpayer. (*Gould v. Gould, supra; United States v. Updike,* 281 U. S. 489; *Burnet v. Niagara Falls Brewing Co.,* 282 U. S. 648.)

5. The legislative history of section 204(c) (2) and the simplicity and clarity of its provisions require its interpretation according to the ordinary meaning of its terms. It is only such an interpretation which will fulfill the pur-

pose of the Legislature that the section should provide a simple means of computing a depletion deduction allowable to each taxpayer having an interest in an oil and gas property.

ARGUMENT.

As has been pointed out in the Statement of Facts set forth in this brief, the lease which was finally assigned to the taxpayer (who is the respondent in this proceeding) provided for the payment to the lessor, as rental or royalty for the use of the land covered by the lease, one-sixth (1/6) of the oil produced and saved from the property. The provision in the lease regarding the royalty payment reads as follows:

> "9. . . . The lessee shall pay as rental or royalty for the use of said land one-sixth (1/6) of all oil produced and saved therefrom, said payment to be made in money or in kind at the lessor's option." [R. 90.]

As additional rent the taxpayer's assignor, in order to secure the assignment of the lease from the original lessee, was obliged to pay one-twelfth (1/12) of the oil produced. The provision of the lease assignment relating to this royalty reads as follows:

> ". . . Party of the second part hereby agrees to perform each and all of the covenants and obligations of said 'Batson' lease agreed to be performed by said F. A. Andrews, one of the parties of the first part hereunder, of every kind and character; and in addition to such performance of said 'Batson' lease, said Thomas H. Lipps, party of the second part hereunder agrees further:

(1) That he will pay to the parties of the first part herein, over and in addition to the one-sixth (1/6) royalty agreed to be paid to the lessors under said 'Batson' lease, one-twelfth of all petroleum, oil, gas and other oil products, and casinghead gasoline, produced and saved from each and all wells on said premises by the party of the second part, said royalty to be paid in lawful money of the United States, or in kind, at the option of the parties of the first part, . . .". [R. 95, 97.]

The lease and assignment thereof were duly assigned to the taxpayer, the Twin Bell Oil Syndicate (respondent in this proceeding). [R. 103.]

Section 204(c) (2) of the Revenue Act of 1926, *supra*, permitted the taxpayer to deduct, as depletion, in the case of oil and gas wells, *27½ per cent of the gross income from the property during the taxable year*. The Commissioner of Internal Revenue, however, interpreted the meaning of gross income, as used in that section of the law, as being the gross income after deducting the royalties paid to the lessor. Consequently, the Commissioner computed the 27½ per cent on a smaller amount as gross income, as a result of which he reduced the taxpayer's deduction for depletion. Taxpayer contended that the computation should be made on its *gross income* before any deduction.

The Board of Tax Appeals, in sustaining the Commissioner, held that section 234(a) (8), which provides for a reasonable allowance for depreciation and depletion and an equitable apportionment of such allowance between the

lessor and lessee, must be read together with section 204 (c) (2) which the Board holds merely specifies the "basis" of a depletion allowance; that by reading these sections together it must be concluded that the 27½ per cent of gross income allowance for depletion is to be equitably apportioned between lessor and lessee; and that therefore of the 27½ per cent of gross income allowable as a depletion deduction, 3/4ths thereof may be deducted by the petitioner who has a 3/4th interest in the oil produced, and 1/4th thereof may be deducted by the lessors and original lessee who had a 1/4th interest in the oil produced.

The United States Circuit Court of Appeals for the Ninth Circuit reversed the Board of Tax Appeals, holding that section 204(c) (2) of the Revenue Act of 1926 provided for an arbitrary allowance for depletion deduction and was not to be controlled in its application by section 234(a) (8); that section 204(c) (2) by its terms clearly provided for a depletion allowance computed at the rate of 27½ per cent of gross income and that, therefore, the gross income should not be reduced by royalties paid.

In support of taxpayer's contentions throughout these proceedings and in support of the decision of the United States Circuit Court of Appeals in this case, the following arguments which have hereinbefore been summarized under the heading "Summary of Argument" are respectfully submitted:

1.

THE TAXPAYER'S GROSS INCOME FROM THE PROPERTY IS THE GROSS PROCEEDS DERIVED FROM THE SALE OF OIL AND GAS PRODUCED.

The Commissioner's contention that the taxpayer's gross income consists of the gross proceeds from the sale of oil and gas produced, reduced by the amount of rents and royalties paid, cannot be supported by the income tax statutes.

Sections 204(c) of the Revenue Act is very concise and contains very simple language. It provides that "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year." Construing the statute by itself, the only questions in its application to this proceeding is whether the term "gross income" includes amounts paid out of income for rents or royalties for the use of the property.

Under the provisions of the lease and assignment thereof regarding royalty payments the taxpayer was entitled to all of the oil and gas produced from the property and was to make payment to the lessees of certain royalties "as rental or royalty for the use of said land." The taxpayer produced and sold all of the oil and gas produced from the property and out of the proceeds of said sales the taxpayer paid the royalties required under the lease and lease assignment. Its books of records reflect the receipt of the gross proceeds from the sale of oil and gas

as gross income and reflect also the payments of the royalties to the lessor and to the assignor of said lease as deductions. [R. 49.]

The sole question stated in a slightly different form than in the preceding paragraph is whether, for the purpose of computing the depletion allowance based on 27½ per cent of the gross income, the gross income shall be the amount of the gross proceeds from the sale of the oil and gas or whether such gross income shall be the amount of the said gross proceeds less the amount of rents and royalties paid. We submit that the conclusion is inescapable that the taxpayer's gross income from the property is the amount of the gross proceeds derived from the sale of oil and gas produced.

Section 213(a) of the Revenue Act of 1927, *supra,* defines gross income in general as being any form of income, whether from salaries, wages, professions, trades, business, *sales,* dealings in property, interest, rent dividends, or gains or profits, or income derived from any source whatever. The income tax law is so compiled that it defines and explains gross income (section 213, 233) from which shall be deducted what are explained and defined as deductions, such as expenses, etc. (section 214, 234), in order to arrive at what is defined and explained as the net income (section 212, 232), which net income is subject to tax. Amongst the deductions which are to be made from gross income in determining net income there are specified in the Revenue Act (section 214(a) (1)) the items of rents and royalties.

The law has now been definitely established that royalty payments under oil and mine leases are not payments for the purchase of property but are in fact rental payments for the use of the property. (*Von Baumbach v. Sargent Land Co.*, 242 U. S. 503; *United States v. Biwabik Mining Co.*, 247 U. S. 116; *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364; *Burnet v. Harmel*, 287 U. S. 103.)

Under the above referred to sections of the Revenue Act the taxpayer was required to include in its gross income its gross proceeds from the *sales* of its oil and gas, and it was then required to include in its deductions the amounts which it paid as rents and royalties. (*Bogle & Co.*, 5 B. T. A. 541, 552):

> "With reference to the minimum royalties, we are of the opinion that they constitute rent and are allowable deductions. It is well settled that royalties paid under the provisions of mining leases constitute rents. (*Lynch v. Alworth-Stephens Co.*, 267 U. S. 364; *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503, and *United States v. Biwabik Mining Co.*, 247 U. S. 116; *James R. Parkey*, 16 B. T. A. 441.)"

The question of whether these royalty payments should first be treated as gross income was recently before the United States Circuit Court of Appeals for the Eighth Circuit in the case of *Comar Oil Co. v. Burnet*, 64 Fed. (2d) 965, affirming 24 B. T. A. That court, in its decision that such royalties should first be included as gross income of the lessee, stated the law to be as follows:

"Gross Income.—It will be apparent upon examination of the statute (Section 213(a)) that the term 'gross income' is broad in scope; broad enough to include, in the case of a lessor, rents or royalties paid to him by the lessee, Von Baumbach v. Sargent Land Co., 242 U. S. 503, 37 S. Ct. 201, 61 L. Ed. 460; United States v. Biwabik Mining Co., 247 U. S. 116, 38 S. Ct. 462, 62 L. Ed. 1017; Murphy Oil Co. v. Burnet, 287 U. S. 299, 53 S. Ct. 161, 77 L. Ed. 168; Burnet v. Harmel, 287 U. S. 103, 53 Sup. Ct. 74, 77 L. Ed. 59; *broad enough also to include, in the case of a lessee, rents or royalties paid by him to the lessor owner; and the practice has been to include them as gross income in the return.* United States v. Boston & Providence R. R. Corp. (C. C. A.), 37 F. (2d) 670; International Textbook Co. v. United States (Ct. Cl.), 44 F. (2d) 254; Baton Coal Co. v. Commissioner of Internal Revenue (C. C. A.), 51 F. (2d) 469; Jefferson Gas Coal Co. v. Commissioner of Internal Revenue (C. C. A.), 52 Fed. (2d) 120; Davison v. Commissioner of Internal Revenue (C. C. A.), 60 Fed. (2d) 50; Merillat v. Commissioner, 9 B. T. A. 813; Kekaka Sugar Co., Ltd. v. Commissioner, 13 B. T. A. 690; Ferguson v. Commissioner, 20 B. T. A. 130.

"We are not insensible to the forceful argument of petitioner that neither original royalties nor overriding royalties should be included in gross income of the lessee, sublessee, or transferee. The argument is one, however, which we think should more properly be presented to the Congress than to the courts.

> The inclusion of royalties in the gross income of the lessee not only finds support in the language of sections 233 and 213 of the Revenue Act of 1921, but also in the actual practice as established during a considerable number of years. See cases cited above." (Italics ours.)

These decisions leave little room for doubt that royalty payments constitute part of the taxpayer's gross income and that for purposes of computing a 27½ per cent depletion allowance the gross proceeds derived from the sale of oil and gas produced must be considered the gross income from the property and must not be reduced by the amount of rents and royalties paid. This was the conclusion of the Circuit Court of Appeals in its decision in this case [R. 204-206] and is consistent with the conclusion of the Circuit Court of Appeals for the Tenth Circuit in the case of *Darby-Lynde Co. v. Alexander,* 51 Fed. (2d) 256, certiorari denied, 284 U. S. 266, as follows:

> *"We conclude that the words 'gross income', as used in section 204(c) (2), supra, mean income derived from the sale or other disposition of oil and gas produced,* and not from the sale of the oil and gas properties." (Italics ours.)

We believe that the foregoing argument establishes that a fair interpretation of the section would require the 27½ per cent computation to be made on the taxpayer's gross income from the property before any deductions for royalties paid.

2.

SECTION 204(c) (2) IS AUTHORITY FOR AN ARBITRARY PERCENTAGE ALLOWANCE FOR OR "APPORTIONED" TO EACH TAXPAYER. IT CANNOT BE CONSTRUED AS PART OF SECTION 234(a) (8) AND THE DEPLETION ALLOWANCE AUTHORIZED BY IT CANNOT BE RESTRICTED BY ANY PROVISION OF SECTION 234(a) (8).

The Commissioner contended, and his contention was sustained by the Board of Tax Appeals, that even though "gross income" included amounts of royalties paid, section 204(c) (2) merely prescribed a basis for computing a depletion allowance,—that that section and section 234(a) (8) of the Revenue Act of 1926 had to be read together as a single statutory provision authorizing the depletion allowance, and that the depletion computable under section 204(c) (2) was particularly restricted by that part of section 214(a) (9) (or 234(a) (8)) which provides "in the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee." The Circuit Court of Appeals reversed the Board and concluded [R. 207] that section 204(c) (2) provided for an "allowance" for depletion and was not to be considered a part of section 234(a) (8).

The conclusion of the Circuit Court is well supported by the legislative history of the sections involved, by the construction and wording of the sections, by other judicial decisions, and by the impracticability of application of a contrary conclusion.

Legislative History of the Provision of Section 214(a) (9) (or 234(a) (8)), Revenue Act of 1926—"In the Case of Leases the Deduction Allowed by This Paragraph Shall Be Equitably Apportioned Between the Lessor and Lessee"—and Reason for Its Retention in the Revenue Act of 1926.

Prior to the Revenue Act of 1926, taxpayers were entitled, under section 204 (b) and (c) of the Revenue Act of 1924 and section 214(a) (10) of the Revenue Acts of 1918 and 1921, to a depletion allowance in case of mines, oil and gas wells discovered by the taxpayer on or after March 1, 1913, computed on the basis of the fair market value of the property at the date of discovery; and where property was acquired prior to March 1, 1913, on the basis of the fair market value on that date. Of the fair market value on the basic date the lessor and lessee had certain proportions according to the value of their respective interests. The total depletion allowable was the depletion of that basic value and provision was then made in all revenue acts enacted after the Revenue Act of 1916 for the equitable apportionment of the allowable depletion between the lessor and lessee.

Under the Revenue Act of 1916 it was first ruled that lessees were not entitled to a depletion deduction (*Weiss v. Mohawk Mining Co.*, 264 Fed. 502; but see later decision of United States Supreme Court in *Lynch v. Alworth-Stephens Co.*, 45 Sup. Ct. 274, decided after enactment of 1918 Revenue Act.) Congress therefore inserted the provision of section 214(a) (10) providing for equitable apportionment of the depletion deduction between lessor and lessee to enable lessees to receive the benefit of the depletion allowance. (Report 767, Committee on

Ways & Means, House of Representatives, on Revenue Bill of 1918, p. 10: "The bill also corrects an inequality of the present law by providing for an equitable apportionment of the depletion allowance between lessor and lessee.")

When the 1926 Act was enacted the provisions for a computation of depletion on discovery values in the case of oil and gas were eliminated. However, the discovery depletion was still permitted in the case of mines, under the provisions of section 204(c) (1) of the Revenue Act of 1926, and depletion on the basis of March 1, 1913 values was still permitted under the provisions of section 204(b) of the Revenue Act of 1926. It was therefore consistent that the provision of section 214(a) (9): "in the case of leases the deduction *allowed by this paragraph* shall be equitably apportioned between lessor and lessee"—be retained.

Legislative History of Section 204(c) (2) of the Revenue Act of 1926 and Reason for Its Enactment.

At the hearings before the Committee on Finance, United States Senate, minutes of which are recorded in a report of said hearings on House Report 1—Revenue Act of 1926, held January 4, 5, 9, 12, 13, 14, of 1926, discussion was had between members of that committee and representatives of the Internal Revenue Bureau regarding the difficulties of administration of the discovery depletion provisions of the Revenue Acts and the advisability of substituting therefor an arbitrary percentage allowance of depletion. (See pages 177, 197, 198, 199, 200 of the report of the hearings.) In report No. 52 of the Senate Committee on Finance concerning the Internal

Revenue Bill of 1926, on page 17, the Finance Committee made the following recommendation regarding discovery depletion in the case of oil and gas wells:

> "The administration of the discovery provision of existing law in the case of oil and gas wells has been very difficult because of the discovery valuation that had to be made in the case of each discovery well. In the interest of simplicity and certainly in administration your committee recommends that in the case of oil and gas wells the allowance for depletion shall be 25 per cent of the gross income from the property during the taxable year. The provision of existing law limiting this amount to an amount not in excess of 50 per cent of the net income of the taxpayer from the property is retained."

When the Revenue Bill of 1926 was finally enacted it gave effect to the recommendation of the finance committee above quoted, excepting that the rate for depletion was changed to 27½ per cent of the gross income. This history of the enactment of section 204(c) (2) must show that the section was intended to allow a purely arbitrary deduction for depletion in the case of oil and gas wells.

This inference would seem authorized by the language of the Supreme Court in the case, *United States v. Dakota-Montana Oil Company,* 288 U. S. 459, 461, 466:

> "But the 'discovery value' provision was eliminated from the Act of 1926, which is applicable here, and the taxpayer was permitted to calculate depletion on the basis of cost alone, section 204(c), or else to deduct an arbitrary allowance, fixed by the statute, without reference to cost or discovery value, at 27½ per cent of gross income from the well.
>
> * * * * * * * *

"It was eliminated under the 1926 Act, being no longer necessary, as the statute omitted the 'discovery value' provision and substituted the arbitrary percentage allowance for depletion."

Section 204(c) (2) Is Complete in Itself and Provides Not for a Basis for Depletion but for the Amount of an Allowance for Depletion to Which Each Taxpayer Is Entitled and Thereby Provides Its Own Apportionment of the Depletion Allowance Authorized by It.

The Board in its decision stated that section 204(c) (2) merely provided a *basis* for the depletion which would be allowable under section 234(a) (8).

The Circuit Court of Appeals ruled otherwise, holding that section 204(c) (2) authorized an arbitrary percentage *allowance* for depletion. We believe the court has given ample argument in its decision in support of this conclusion [R. 204-205] and we respectfully submit its conclusion should be sustained.

The Commissioner argues—

"It is unreasonable to suppose that Congress intended that a multiplication of interests in the property should result in a greater allowance for depletion than the owner himself would be allowed if he operated the property. It is far more reasonable to assume that Congress intended that the percentage deduction allowable to all having an economic interest should amount in the aggregate to 27½ per cent of the gross income from the property, that is, from production, and that this amount should be equitably apportioned between all having such interest. There is no apportionment on any other theory."

The premise upon which this argument is founded is that section 204(c) (2) provides for a predeterminable definite aggregate depletion allowance to all taxpayers interested in an oil and gas property. We do not believe such a premise can be sustained. Congress intended that under section 204(c) (2) *each taxpayer* should be entitled to an *arbitrary* depletion allowance subject to certain restrictions. It is fundamental that the taxing statutes govern the tax computation of each person or entity subject to tax. Nowhere do the taxing statutes recognize a group of persons having royalty interests in an oil well as a separate taxable entity. Section 204(c) (2) must therefore apply to each taxable person, and under it each taxable person may compute his depletion allowance on the basis of 27½ per cent of his gross income from the property, regardless of the amount of gross income realized by any other person interested in the property. As to "apportionment," if the requirement of apportionment must be met, we submit that section 204(c) (2) by its terms effects the apportionment by providing that each taxpayer be allowed depletion on the basis of 27½ per cent of his gross income from the property not to be in excess of 50 per cent of his net income. Some of the taxpayers interested in the property may find their depletion allowance restricted by the 50 per cent of net income provision; others may not be so restricted; others, such as operating lessees, may suffer losses in the operation of the property and thus be entitled to no depletion under this section. If we must find the aggregate arbitrary allowance under section 204(c) (2), it would be the total of the "apportioned" *arbitrary allowances* computed as indicated above. Whether that aggregate would

be more or less, and it might be either, than a single operating owner of the property might have been allowed, is immaterial.

If this Honorable Court should affirm the Circuit Court's conclusion that section 204(c) (2) was a statutory provision complete in itself, and authorizing an allowance for depletion, we feel it would follow that the provisions of section 204(c) (2) would in no wise be controlled by section 234(a) (8) excepting in one event which would be the instance when the depletion allowance computed under section 214 (234) would be *greater* than the allowance computed under section 204(c) (2) in which case the greater allowance would be the depletion deduction to which the taxpayer is entitled. However, in the event this court should not agree with this conclusion, we respectfully submit the following argument to show that sections 234(a) (8) and 204(c) (2) are independent of each other and are not to be read together as a single statutory provision authorizing a depletion allowance.

Both Section 214(a) (9) (234(a) (8)) and Section 204 (c) (2) Provide for the Allowance for Depletion.

It is respectfully submitted that section 204(c) (2) is a complete and separate and distinct statutory provision for the deductibility of a depletion *allowance* in the case of oil and gas wells. Under this construction section 234(a) (8) is authority for the allowance of depletion on the basis of cost or March 1, 1913 value, or discovery value in the case of mines, which bases are authorized under section 204(c) and (c)(1); and section 204(c) (2) is authority for the allowance of an arbitrary amount of depletion in the case of oil and gas wells.

Section 204(c)(2) presupposes the existence of another stautory provision authorizing a depletion computation, for it contains the proviso that "in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph." Since section 204 (c) (2) by its own terms authorizes *the allowance* for depletion at the rate of 27½ per cent of gross income, a computation without reference to section 204(c) (2) must be a computation under another section authorizing an allowance for depletion.

The Depletion Allowance Computed Under Section 204(c) (2) Is the Least Amount Allowable as a Depletion Deduction. Therefore, Section 234(a) (8) Cannot Restrict Section 204(c) (2) so as to Reduce the Depletion Deduction Below the Allowance Computed Under Section 204(c) (2).

We have hereinbefore pointed out that prior to the Revenue Act of 1926 depletion was computed on the basis of certain values and in the computation of this depletion it was required that the allowable deduction should be reasonable. The same provision for depreciation and depletion computation was carried over into the Revenue Act of 1926 with the exception that the authority for computing depletion on discovery value was eliminated. There was then inserted in the Revenue Act of 1926 section 204(c) (2), which authorized an arbitrary allowance for depletion in the case of oil and gas wells in a certain definite amount subject to certain limitations (50 per cent of net income).

Section 234(a) (8) cannot restrict section 204(c) (2). Since section 204(c) (2) specifies that the depletion shall

be a definite amount, that is, 27½ per cent of gross income, there is no necessity for the restriction that the amount so computed should be reasonable. It might very probably be that in the viewpoint of some reviewing bodies the depletion allowance of 27½ per cent of the gross income might not be reasonable. However, it can certainly not be argued that because of such unreasonableness the allowance authorized by section 204(c) (2) cannot be allowed, but must be subject to the restrictions of section 234(a) (8). To that extent, it must be conceded that the two sections are not to be read together.

Section 204(c) (2) itself specified the only instance and purpose in which section 234(a) (8) should be considered, and that purpose is to determine whether the depletion allowance computed under section 234(a) (8) is more or less than the allowance computed under section 204(c) (2).

Section 204 (c) (2) provides, *"in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."* It is quite clear that the allowance provided for by section 204(c) (2) shall be the lowest depletion allowance to which the taxpayer shall be entitled. If a *greater* depletion allowance is computable under any other paragraph of the statute, the taxpayer should be allowed the greater amount. However, if the depletion allowable under any other paragraph should be less than the allowance computed under section 204(c) (2), then the taxpayer shall be allowed the amount computed under section 204(c) (2). The Commissioner and the Board of Tax Appeals violate this injunction of section 204(c) (2). In effect, the Commissioner and the Board compute the allowance under section 204(c) (2)

and then reduce it by apportioning the allowance under the provisions of section 234(a) (8). Since section 204 (c) (2) provides that the depletion allowance "shall be" 27½ per cent of gross income (subject to 50 per cent of net income limitation which is not in question in this controversy) unless a *greater* allowance is computable under another section, the Circuit Court of Appeals was correct in reversing the decision of the Board which restricted the depletion allowance to this taxpayer to an amount less than 27½ per cent of the gross income.

There Is No Reason for Making Sections 234(a) (8) and Section 204(c) (2) a Part of Each Other, Since the Depletion Allowance Under Section 204(c) (2) Is Arbitrary and Distinctly Different in Nature Than the Depletion Allowable Under Section 234(a) (8).

There is no necessity for making section 234(a) (8) a part of section 204(c) (2). Under section 234(a) (8) the depletion allowable represents an annual return of a definite capital sum. Every specified basis for depletion is a specific capital sum to be returned to the taxpayer tax-free through the allowance as a deduction of the depletion allowable under section 234(a) (8). This is not true as to section 204(c) (2). This section specifies the exact amount of depletion allowance and it provides that such allowance shall not exceed 50 per cent of the net income of the taxpayer, and it provides further that such allowance *shall not be less* than it would be if computed under some other section of the statute. The very fact that the provision is so arbitrary in nature is some proof of the contention that the allowance is not intended as a

return of a definite aggregate capital value to all persons interested in oil and gas wells. The Commissioner of Internal Revenue himself recognizes this feature of the statute. In his decision promulgated IT:2327 C. B. June, 1927, page 18, the Commissioner held:

> "The *allowance* for depletion provided by section 204(c) (2) of the Revenue Act of 1926 in the case of oil and gas wells constitutes an allowable deduction under the Revenue Act of 1926 notwithstanding there is no depletable capital sum based upon cost."

This ruling is very significant, since it shows that the Commissioner himself recognizes that section 204(c) (2) specifies an *allowance* for depletion and not merely a basis for depletion. Furthermore, in his ruling, the Commissioner recognizes that this arbitrary depletion is to be allowed regardless of whether the taxpayer has any recognized capital sum remaining to be returned to him. Since this section is not designed to return to either lessor or lessee any particular capital sum, and since it shows no discrimination in cases where a lessor has a capital sum remaining and lessee has no capital sum remaining, and gives no consideration to any factors in relation to the interests of the taxpayers receiving income from oil and gas wells, we see no reason why the statute should be construed as a part of section 234(a) (8) prescribing a definite depletion allowance which must be apportioned between lessor and lessee.

3.

THE PROVISION THAT THE DEPLETION DEDUCTION IS TO BE EQUITABLY APPORTIONED BETWEEN LESSOR AND LESSEE IS NOT A PART OF SECTION 204(c) (2) BUT APPLIES ONLY TO DEPLETION COMPUTED UNDER SECTION 234(a) (8).

Regarding the above proposition, the Circuit Court of Appeals stated [R. 207]:

> "We advance, finally, to the troublesome question of equitable apportionment, so earnestly insisted upon by the Commissioner and by the Board.
>
> "As we have seen, this subject is covered by section 214(a) (9) and section 234(a) (8), *supra.*
>
> "In the first place, it is observable that both sections deal with 'mines, other natural products, and timber', as well as with oil and gas wells. They are therefore, in a sense, general provisions. It is elementary that 'General language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment.' *Ginsberg & Sons v. Popkin,* 285 U. S. 204, 208.
>
> "Secondly, the section specifies that the deduction—*i.e.,* the 'reasonable' deductions—*allowed by that paragraph*—shall be equitably apportioned. But that does not mean that the 'arbitrary' deduction allowed by section 204(c) (2) should likewise be 'equitably' apportioned. Here again we are confronted by the rule that all doubtful intendments should be construed in favor of the taxpayer."

The provisions of section 204(c) (2) are simple and couched in the plainest of language. It allows depletion at the rate of 27½ per cent of gross income. The Board of Tax Appeals, by reading into it portions of section 214 (234), makes it ambiguous and complicated, and injects a meaning which would necessitate intricate computations to determine the depletion allowance. This result is directly in conflict with the expressed intent of the Legislature as to the purpose of this section.

The Board's interpretation of section 204(c) (2) clearly extends its provisions beyond the import of the language used. In so doing the Board violated the fundamental rule that "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions by implication, beyond the clear import of the language used or to enlarge their operations so as to embrace matters not specifically pointed out." (*Gould v. Gould,* 245 U. S. 151.)

We believe the conclusion of the Circuit Court should be sustained.

The Board Has Erroneously Defined "Equitable Apportionment." An Equitable Apportionment of Depletion Deductions Cannot Be Arrived at by a Division of an Aggregate Depletion Allowance to a Lessor and Lessee on the Basis of Their Pro Rata Interest Under an Oil Lease.

The Circuit Court of Appeals avoided any discussion of the Board's interpretation of "equitable apportionment" by concluding that the statutory provision for equitable apportionment of the depletion deduction did not apply to the depletion allowance under section 204(c) (2).

[R. 207.] We believe the Circuit Court to be correct in this conclusion and if this Honorable Court should sustain the Circuit Court's decision on this point, the argument under this subheading is unimportant. However, if this Honorable Court should disagree with the conclusion of the Circuit Court, we respectfully submit this argument to show that the Board's interpretation of "equitable apportionment" is fundamentally unsound and creative of impractical if not impossible situations.

The Board, affirming the Commissioner's contention, concluded that a depletion deduction is equitably apportioned between lessor and lessee when an aggregate depletion allowance is divided between them on the basis of their stated interests under an oil lease. We believe the fallacy of such a conclusion can be very readily disclosed.

The provision for equitable apportionment of the depletion allowance between lessor and lessee, when first inserted in the Revenue Act of 1918, was intended to permit a lessee to deduct an allowance for the depletion of his interest (*supra*, p. 20). It was never intended to mean a division between lessor and lessee of an aggregate total annual depletion allowance for the property and the Commissioner has never so applied it. The lessor's depletion is computed separately, and the lessee's depletion is computed separately. Many factors enter into the depletion computation which might affect one party and not the other. (Note Articles 203 and 204 and 207 of Regulations 69, quoted in Appendix hereto.) Usually the lessor takes no part in and makes no expenditures for the development of the property, and thus the lessee, by building up a large cost for his interest, may be entitled to a

large amount of depletion whereas his lessor, with a very small cost for his interest, may be entitled to a comparatively small depletion allowance. A very simple example will serve to illustrate this point:

Example to Illustrate Futility of Equitable Apportionment of Aribtrary Depletion Allowance Under the Theory Adopted by the Board.

Supposing an operating lessee of an oil property and a lessor start at March 1, 1913, with a basic March 1, 1913, value to each for his respective interest in the property. Let us assume these factors to exist:

	Lessor Interest (1/8)	Lessee Interest (7/8)
Recoverable Oil Reserve	1,000,000 Bbls.	7,000,000 Bbls.
Capital Sum (3/1/13 value)	$500,000.00	$3,500,000.00

The unit of depletion in each case is 50 cents per barrel —in other words, the return of capital or depletion allowance is 50 cents on each barrel produced. Now let us assume that in 1925 the operating lessee has added $700,000 to his costs for development, and that the following factors exist for 1926:

Remaining Recoverable Oil Reserve	500,000 Bbls.	3,500,000 Bbls.	
Remaining Capital Sum	$250,000.00	$1,750,000.00	
		plus 700,000.00	added in 1925
		$2,450,000.00	
Depletion Unit (Remaining Capital Sum ÷ Remaining Reserves)	.50	.70	
1926 Production	10,000 Bbls.	70,000 Bbls.	
Depletion Allowable (Sec. 214)	$5,000.00	$49,000.00	

Let us also assume that $1.00 per barrel sales price was received for the oil sold in 1926, or, $80,000 gross proceeds from all oil sold.

Under section 204 (c) (2) under the Board's decision in this *Twin Bell* case, the depletion would be 27½ per cent of $80,000, or $22,000 to be apportioned ⅛ or $2,750.00 to the lessor and ⅞ or $19,250.00 to the lessee.

By this computation, it is evident that an equitable apportionment of depletion under section 214 or 234 shows the lessee to be entitled to a depletion of almost 10 times that to which the lessor is entitled. Yet under the Board's construction, the equitable apportionment of depletion computed under section 204 (c) (2) would entitle the lessee to but 7 times more depletion than the lessor.

To arrive at a true "equitable apportionment" to all parties interested in an oil property of a definite depletion deduction which under the Board's theory cannot in the aggregate exceed 27½ per cent of the total proceeds of the property, would involve the very intricate computations which it was the Legislature's intention to avoid when it enacted section 204 (c) (2). There may be a number of persons receiving royalties from an oil property and their interests in the property may vary from percentages of gross income to percentages of net income. In such a case it would be practically impossible to determine a depletion allowance under the method prescribed by the Board.

In the discussion of the above example we have made no mention of the restriction contained in section 204 (c) (2) that the depletion allowance cannot exceed 50 per cent of the net income. This restriction, however, should be kept in mind. It may be that a lessee will have no net income while a lessor's net income may be its gross income.

It is obvious, therefore, that there was not intended that there should be such an apportionment of allowable depletion deductions that the amounts allowed to lessor and lessee should add to a predetermined definite aggregate depletion allowance. Unless the lessor or lessee or anyone else having an interest in the oil property realizes a net income, he can receive no depletion allowance under section 204 (c) (2), unless he is entitled to a depletion deduction under section 234 (a) (8), to which he would be entitled by virtue of the provision in section 204 (c) (2) that in no case is the depletion deduction to be less than if computed without reference to that paragraph.

Further Example to Illustrate Board's Failure to Properly Analyze Concept of Section 204(c) (2).

Supposing that a lessor and lessee agree that the lessee will pay a royalty of 25 per cent of the *net income* from the property, and that during a taxable year the following factors exist:

Gross proceeds from sale of oil	$200,000.00
Net income—before computing royalty	$ 80,000.00
Royalty—25% of $80,000.00	$ 20,000.00
Net income after deducting royalty	$ 60,000.00

Under the Board's theory the depletion under section 204 (c) (2) would be 27½ per cent of $200,000.00 or $55,000.00 to be apportioned as follows:

Lessor—25%	$ 13,750.00
Lessee—75%	26,250.00

and the depletion allowable to both lessor and lessee would be as follows:

Lessor:		
27½% depletion	$13,750.00	
50 % of lessor's net income ($20,000.00) Limitation Sec. 204 (c) (2)	10,000.00	
Depletion allowable under theory of Board decision		$10,000.00
Lessee:		
27½% depletion	$26,250.00	
50 % of lessee's net income ($60,000.00)	30,000.00	
Depletion allowable under theory of Board's decision		$26,250.00

We have hereinbefore pointed out that under court decisions, the gross proceeds realized by an operating lessee from the sale of oil constitute gross income to him, and that rents or royalties paid to a lessor represent gross income to him. Yet, under the Board's theory, as applied to the above illustration, the depletion allowable to the lessor would be based on a portion of the lessee's gross income and would be $10,000.00 (or 50% of his net income), although the lessor's gross income was but $20,000.00, and 27½% of $20,000.00 is but $5,500.00. This is in direct violation of section 204 (c) (2), which states the depletion allowance shall not exceed 27½% of the gross income from the property. It must be granted that logic and the general form of construction of Revenue

Statutes require the interpretation of section 204 (c) (2) to mean that that section applies to each taxpayer independently of its application to any other taxpayer. And it must logically follow that the term "gross income from the property" must mean the gross income realized by the taxpayer who is claiming a depletion deduction under that section, from the property.

A lessor realizes the amount of his royalty as his gross income from the property (*supra*, p. 16). The Board's theory causes a direct violation of this law, since under the Board's theory the lessor's gross income from the property upon which the 27½ per cent would be computed would be some arbitrary *apportionment* of another taxpayer's gross income.

Would it not be a simple matter and more in harmony with the intent of the Legislature when it enacted section 204 (c) (2) if the following solution to the above illustration could be made by each taxpayer:

	Lessor	Lessee
Gross income from property	$20,000.00	$200,000.00
Net income from property	20,000.00	60,000.00
27½% of gross income	5,500.00	55,000.00
50 % of net income	10,000.00	30,000.00
Depletion allowable under Section 204 (c) (2)	5,500.00	30,000.00

And each taxpayer could compile his own tax return without the necessity imposed by the Board decision of inquiring from the operating lessee the record of income

from the well and the method of "apportionment" of a depletion deduction to be computed against that income.

The Board's theory of the concept of section 204 (c) (2) is that it allows a gross depletion allowance to groups of taxpayers and not to individual taxpayers; and that the term "gross income" as used therein means the gross income realized by the taxpayer who is the operator of the business in which the group is interested. This is, of course, contrary to the fundamental concept of the Revenue Statutes, which are intended to prescribe the gross income deductions, taxable net income, and tax of *each* taxpayer, and certainly do not authorize the computation of a deduction based on another taxpayer's income.

Under the Board's theory, each person interested in an oil well will be obliged to learn from the taxpayer who operates the well what *that taxpayer's* gross income from the well amounts to, before he can compute his depletion allowance, and he then deducts his share of the depletion based on another taxpayer's gross income regardless of the amount of his own gross income. This could not have been intended in a statute enacted for the purpose of simplifying the computation of depletion. Nor is it reasonable that a taxpayer must compute his deductions on the basis of the gross income of another taxpayer.

4.

AMENDMENT CONTAINED IN SECTION 114(b)(3) OF REVENUE ACT OF 1932 IS NEW LAW.

Congress must have appreciated the force of the contention now being made by this petitioner. In the 1932 Revenue Act, section 114 (b) (3) which corresponds to section 204 (c) (2) of the Revenue Act of 1926 and section 114 (b) (3) of the Revenue Act of 1928, reads:

> "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, *excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property.*"

The portion in italics is a new provision not contained in the earlier acts. Since it is a provision for exclusion of matter otherwise included in the general language of the rest of the section, it must be construed as an amendment of the old law and not a declaration of the meaning of the old law.

The deliberate selection of language so differing from that used in the two earlier Revenue Acts indicates that a change of law was intended. Ordinarily, statutes establish rules for the future, and they will not be applied retrospectively unless that purpose plainly appears. *U. S. v. Magnolia Co.*, 276 U. S. 160, 162; *Brewster v. Gage*, 280 U. S. 327; *Russell v. U. S.*, 278 U. S. 181.

There is no indication in the Legislature Reports on the Revenue Bill of 1932 that section 114 (b) (3) as amended in the Revenue Act of 1932 was to be given retrospective effect.

It would therefore appear that the earlier statutes permitted a depletion allowance of 27½ per cent of gross income without exclusion from that gross income the amounts of royalties paid.

The Circuit Court of Appeals was correct in its conclusion that—

> "It will be observed that, with the exception of the provision for the exclusion of rents or royalties, the 1932 enactment is identical with the corresponding section of the Revenue Act of 1926, section 204 (c) (2), *supra*. This new qualifying phrase, not found in the Act of 1926, amounts, it would seem, to a legislative interpretation of the Act of 1926 as *not* excluding rents or royalties from gross income. It is at least a legislative recognition that the language used in the 1926 section was ambiguous. And if ambiguity exists, it must be resolved in favor of the taxpayer.
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> * * * * * * * *
>
> "So here we believe that the 'change of phraseology' in the 1932 Act is 'significant' of the legislative construction of the Act of 1926."

The Amendment as Contained in Section 114(b) (3) of the Revenue Act of 1932, Disproves the Board's and Commissioner's Theory as to the Depletion Allowance Intended by Section 204(c) (2) of the Revenue Act of 1926.

The Board held that because section 234 (a) (8) contained the provision that the depletion allowance must be equitably apportioned between lessor and lessee, it became a part of section 204 (c) (2) and therefore the depletion allowance of 27½ per cent of the gross income from the

property must be apportioned between lessor and lessee according to their proportionate interest under the lease.

Section 23 (1), Revenue Act of 1932, still contains the provision for equitable apportionment of the depletion deduction between lessor and lessee. So, under the Board's theory, it must still be considered as a part of section 114 (b) (3) of the Revenue Act of 1932, and it would still be necessary to apportion the depletion allowance computed under section 114 (b) (3).

It is obvious that Congress intended to reduce the gross income upon which a lessee under the previous laws had the right to compute the 27½ per cent depletion allowance, and the amendment has exactly that effect if the amended section is interpreted as meaning each taxpayer may take 27½ per cent of his gross income from the property reduced by royalties paid. But it would not have that effect if the Board's theory is followed because under the Board's theory it would still be necessary to take the gross income from the property, exclude therefrom royalties paid, compute 27½ per cent on the remainder, to arrive at the depletion allowance, and then apportion the resulting depletion allowance between lessor and lessee. Such a construction is not consistent with the ordinary meaning of the language used in the statute (*Gould v. Gould, supra*) and violates the expressed intent of the Legislature to provide by this allowance of a purely arbitrary amount, a simple means of computing a depletion allowance for each taxpayer interested in oil and gas wells; and it further violates sound tax principles by establishing a deduction to one taxpayer based on another taxpayer's gross income.

5.

EVERY TAXPAYER HAVING INTEREST IN OIL PROPERTY IS ENTITLED TO COMPUTE ITS SEPARATE ALLOWANCE BY APPLYING SECTION 204(c) (2).

In the case of *Palmer v. Bender,* 77 L. Ed. (Adv. Op.) 338, the United States Supreme Court held that every person having an economic interest in the oil reserve is entitled to a deduction for depletion. Each taxpayer, therefore, having such an interest is entitled to take 27½ per cent of his gross income from the oil property as his allowance for depletion under section 204 (c) (2). He is not obliged to make a computation of his proportion of any total aggregate depletion allowance which is to represent a maximum allowance to be apportioned between those persons having an interest in the property. He will show his receipts from the oil property as his gross income; he will take therefrom his deductions to arrive at his net income from the property; he will then compute his 27½ per cent of his gross and, if that figure is not in excess of 50 per cent of his net income, it will represent his depletion allowance under this section.

We respectfully submit that this conclusion is supported by the wording of section 204 (c) (2), by the manner in which Congress amended this section in section 114 (b) (3) of the Revenue Act of 1932, and by the expressed intent of Congress that this section should provide a simple means of computing the depletion allowance.

Against this conclusion the Commissioner argues "Congress intended to allow for depletion a flat 27½ per cent of the total income produced by the well, irrespective of to whom this income was attributable; that in the case of

leases this total allowance is to be apportioned equitably between the lessor and lessee," on the basis of their respective interests in the property.

That the Commissioner's argument is not convincing can readily be demonstrated. It is not uncommon to have a number of persons receiving royalties from one property—some having a percentage of gross receipts, some having a percentage of gross receipts after payment of landowner's royalty, and some sharing in the net income after payment of all other royalties and expenses. It would be almost impossible to "equitably apportion" a depletion allowance in such a case by the methods of computation contended for by the Commissioner and the Board. As a further illustration of the fallacy of this argument, we have hereinbefore discussed an example of application of the Commissioner's contention which shows a result unquestionably violative of the provision of the statute (*supra*, p. 35).

In its reports of the Revenue Bill of 1926 (*supra*, p. 21), Congress did express itself to the effect that section 204 (c) (2) was enacted for the purpose of providing a simple means of determining the depletion allowance, and of avoiding intricate computations. If the Commissioner's contention converts the clear and simple language of section 204 (c) (2) into a number of complicated innuendoes, and converts the simple means for computing depletion provided for in the unambiguous terms of the statute, into a formula involving intricate computations, the expressed intention of Congress in favor of simplicity is sufficient in itself to refute the Commissioner's contention.

Even if there should be any doubt as to the interpretation of the provisions of this statute (section 204 (c) (2)) or as to the connotation of the terms used, and another meaning might be adopted, the fact of their use in a tax statute would incline the scale to the construction most favorable to the taxpayer.

Gould v. Gould, supra;

United States v. Updike, 281 U. S. 489;

Burnet v. Niagara Falls Brewing Co., 282 U. S. 648.

This petitioner submits that section 204 (c) (2) of the Revenue Act of 1926 applies to it as an individual taxpayer, and authorizes it to compute its depletion deduction on the basis of 27½ per cent of its gross income, with the restriction that such allowance shall not exceed 50 per cent of its net income. There is nothing in the statute to compel this petitioner to share *its* depletion allowance with anyone else interested in the property. All other persons interested in the oil property are entitled to compute their depletion allowance under section 204 (c) (2) by taking 27½ per cent of their respective gross income from the property. There is no 100 per cent depletion allowance under this section, to which all parties interested are entitled to a pro rata benefit, and which *after having been computed,* must be "apportioned" amongst the parties interested. The section merely provides a percentage depletion allowance to which each taxpayer is entitled based on his own gross and net income from the oil and gas property.

Conclusion.

The judgment of the court below is correct and should be affirmed.

Respectfully submitted,

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October, 1934.

APPENDIX.

Statutes Involved.

REVENUE ACT OF 1926:

Section 204 (a).

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—"

Section 204 (b).

"The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property (or, in the case of such property as is described in paragraph (1), (4), or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date."

Section 204 (c).

"The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—"

Section 204 (c) (2).

"In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allow-

ance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph." (Section 114 (b) (3) of the Revenue Act of 1928 contains the same provision of Section 204 (c) (2) of the Revenue Act of 1926 above quoted.)

REVENUE ACT OF 1932:

Section 114 (b) (3).

"Percentage Depletion for Oil and Gas Wells.—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

REVENUE ACT OF 1926:

Section 212 (a), (232 (a)).

"In the case of an individual the term 'net income' means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206."

Section 233 (a).

"In the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217. . . ."

Section 213.

"For the purposes of this title, except as otherwise provided in section 233

(a) The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period."

Section 214 (a) (and 234 (a) (1)).

"In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually ren-

dered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity; . . ."

Section 214 (a) (9) (and Sec. 234 (a) (88)).

"In computing net income there shall be allowed as deductions:

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; . . ."

REVENUE ACT OF 1932:

Section 23 (1).

"*Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than

the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitable apportioned between the lessor and lessee. . . ."

REGULATIONS 69 (Relating to Revenue Act of 1926):

Article 221.

"Under Section 204 (c) (2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or the value at the basic date, as the case may be. . . ."

Article 203.

"*Amount returnable through depletion and depreciation deductions in the case of lessee.*—(a) In the case of a lessee, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity in the property plus (2) subsequent allowable capital additions and minus (3) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, and minus (4) the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation. The pro-

visions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

(b) The values of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(c) The value of a lessee's equity, if acquired prior to March 1, 1913, is to be taken to mean (1) its cost or (2) the value of his interest in the mineral as of that date, whichever is greater.

(d) The value of a lessee's equity in a proven mineral property acquired on or after March 1, 1913, is to be taken to mean its cost.

(e) The value of a lessee's equity in a discovery after February 28, 1913, is the fair market value at date of discovery, or within 30 days thereafter, of his equity in the mineral discovered."

Article 204.

"*Amount returnable through depletion and depreciation deductions in the case of lessor.*—(a) In the case of a lessor, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value of his equity in the property at the basic date minus (2) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, plus (3) subsequent allowable capital additions, and minus (4) the value of the land at the basic date for other purposes than mineral production and the residual value of other property at the end of operations. The amount re-

turnable through depletion is the total capital remaining less the sum recoverable through depreciation. The provisions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

(b) The values of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(c) The value of the lessor's equity in the case of a mineral property not under lease on March 1, 1913, but subsequently leased, is to be taken to mean (1) the cost or (2) the *en bloc* value of the mineral in the ground on March 1, 1913, whichever is greater, and will, in the absence of satisfactory evidence to the contrary, be presumed not to exceed the value as of March 1, 1913, of the royalties to be expected under the lease.

(d) The value of a lessor's equity in a mineral property under lease March 1, 1913, for the entire operating life of the mineral deposits is to be taken to mean (1) the cost of (2) the value as of March 1, 1913, of the royalties and other payments to be expected under the terms of the lease in effect on that date, whichever is greater.

(e) The value of a lessor's equity in a mineral property under lease March 1, 1913, for a portion of its operating life is to be taken to mean (1) the cost or (2) the value as of March 1, 1913, of the royalties expected from the mineral to be extracted during the life of the existing lease plus the estimated *en bloc* value of the mineral remaining at its expiration, which, in the absence of satis-

factory evidence to the contrary, will be presumed not to exceed the value as of March 1, 1913, of royalties which could have been expected as at that date from the remaining mineral.

(f) The value of a lessor's equity in a mineral property when acquired on or after March 1, 1913, is to be taken to mean its cost.

(g) The value of a lessor's equity in a discovery after February 28, 1913, is the fair market value at the date of discovery, or within 30 days thereafter, of his equity in the mineral discovered."

Due service of the within brief is hereby acknowledged this.....day of October, A. D. 1934.

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Counsel for Petitioner.

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CHARLES ELMORE

IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1934.

No. 170.

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

Twin Bell Oil Syndicate,

Respondent.

SUPPLEMENT TO RESPONDENT'S BRIEF.

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SUPPLEMENT TO RESPONDENT'S BRIEF.

The Circuit Court of Appeals for the Ninth Circuit held in this case that section 204(c) (2) of the Revenue Act of 1926 provided for the allowance of a depletion deduction based on 27½ per cent of gross income and that said section was complete in itself. As authority for the percentage depletion allowance, the Circuit Court also held that the gross income upon which the 27½ per cent was to be computed was in effect the gross proceeds derived from the sale of oil and gas, and further, that such gross income was not to be reduced by royalties paid, before computing the 27½ per cent deduction.

In the brief for the respondent, heretofore filed with this Honorable Court, argument was submitted in support of the conclusions of the lower court. Since the preparation of that brief, the respondent has discovered the decision of this Honorable Court in the case of *Old Colony Railroad Company v. Commissioner,* 285 U. S. 552, 76 Law. Ed. 484, which involves the rules of statutory construction especially applicable to this proceeding and the respondent respectfully submits this supplement to its brief to call this case to the court's attention and to show briefly its applicability to the instant proceeding.

In the *Old Colony Railroad Company* case the Old Colony Railroad Company had sold bonds at a premium. It was claiming as a deduction from its gross income the full amount of interest paid on these bonds. The Commissioner contended that the deduction for interest authorized by statute was intended by Congress to mean the total amount of interest paid less a pro rata of the premium received by the company upon the sale of its bonds. This court in discussing this contention stated as follows:

> "The argument is that although the regulations are inaptly phrased and are susceptible of the construction petitioner places upon them their real intent was to adjust the nominal interest paid on a corporation's indebtedness to the actual amount it is paying for the use of the money represented by the par of the bond,—that is, to what accountants have called the "effective rate" of interest." * * *
>
> * * * * * * * *
>
> "The Commissioner must and does go farther and contends that the receipt of such a premium reduces the item of interest paid and renders the sum nomi-

nated as such in the bond something different from the 'interest . . . on its indebtedness' mentioned in §234 of the Revenue Act of 1921 as a permissible deduction from gross income.

"In other words the contention is that by the use of the quoted phrase the statute did not intend to allow the deduction of the amount agreed to be paid, which the contract denominates 'interest', but of a different sum to be ascertained by a calculation which will allocate the payment between a partial and ratable return of the premium and 'effective' interest on the par of the security.

"Is this the reasonable construction of the language of the act,—'all interest . . . on its indebtedness?'

The rule which should be applied is established by many decisions. 'The Legislature must be presumed to use words in their known and ordinary signification.' Levy v. M'Cartee, 6 Pet. 102, 110, 8 L. Ed. 334, 337. *'The popular or received import of words furnishes the general rule for the interpretation of public laws.'* Maillard v. Lawrence, 16 How. 251, 261, 14 L. Ed. 925, 930. And see United States v. Buffalo Natural Gas Fuel Co., 172 U. S. 339, 341, 43 L. Ed. 469, 470, 19 S. Ct. 200; United States v. First Nat. Bank, 234 U. S. 245, 258, 58 L. Ed. 1298, 1303, 34 S. Ct. 846; Caminetti v. United States, 242 U. S. 470, 485, 61 L. Ed. 442, 452, L. R. A. 1917F, 502, 37 S. Ct. 192, Ann. Cas. 1917B, 1168. As was said in Lynch v. Alworth-Stephens Co., 267 U. S. 364, 370, 69 L. Ed. 660, 662, 45 S. Ct. 274, *'the plain,*

obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and ingenuity and study of an acute and powerful intellect would discover.' This rule is applied to taxing acts; De Ganay v. Lederer, 250 U. S. 376, 381, 63 L. Ed. 1042, 1044, 39 S. Ct. 524.

"Applying the accepted tests to the language of the statute, we are of the opinion that the construction contended for by the commissioner is inadmissible. In common parlance the bonded indebtedness of a corporation imports the total face of its outstanding bonds—the amount which must be paid at their maturity. The phrase is not generally used to connote par plus an unreturned proportion of premium.

"And as respects 'interest,' the usual import of the term is the amount which one has contracted to pay for the use of borrowed money. He who pays and he who receives payment of the stipulated amount conceives that the whole is interest. In the ordinary affairs of life no one stops for refined analysis of the nature of a premium, or considers that the periodic payment universally called 'interest' is in part something wholly distinct—that is, a return of borrowed capital. It has remained for the theory of accounting to point out this refinement. We cannot believe that Congress used the word having in mind any concept other than the usual, ordinary and everyday meaning of the term, or that it was acquainted with the accountants' phrase 'effective rate' of interest and intended that as the measure of the permitted deduc-

"In short, we think that in the common understanding 'interest' means what is usually called interest by those who pay and those who receive the amount so denominated in bond and coupon, and that the words of the statute permit the deduction of that sum, *and do not refer to some esoteric concept derived from subtle and theoretic analysis.*

"If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer. Gould v. Gould, 245 U. S. 151, 62 L. Ed. 211, 38 S. Ct. 53; United States v. Merriam, 263 U. S. 179, 68 L. Ed. 240, 29 A. L. R. 1547, 44 S. Ct. 69; Bowers v. New York & A. Lighterage Co., 273 U. S. 346, 71 L. Ed. 676, 47 S. Ct. 389; United States v. Updike, 281 U. S. 489, 74 L. Ed. 984, 50 S. Ct. 367; Burnet v. Niagara Falls Brewing Co., 282 U. S. 648, 75 L. Ed. 594, 51 S. Ct. 262." (Italics ours.)

We respectfully submit that under the rules of statutory construction applied in the above decision the words of Section 204(c)(2) of the Revenue Act of 1926 permit the depletion allowance to be computed on the basis of 27½ per cent of the taxpayer's gross income from oil and gas property, and do not refer to some esoteric concept derived from the subtle and theoretic analysis propounded by the Commissioner, which, as indicated in the principal brief for the respondent filed herein, would require the insertion of the provisions of another section of the

Statute (Sec. 234(a)(8) as a part of Sec. 204(c)(2), the grouping of taxpayers in order to compute an aggregate depletion allowance, and an intricate computation to determine the proportion of the aggregate allowance to which each of the taxpayers in the group would be entitled.

We respectfully submit that the lower court's decision should be affirmed.

Respectfully submitted,

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November, 1934.

SUPREME COURT OF THE UNITED STATES.

No. 170.—October Term, 1934.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Twin Bell Oil Syndicate.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 3, 1934.]

Mr. Justice Roberts delivered the opinion of the Court.

Under the Revenue Act of 1926 the taxpayer is entitled, in the case of oil and gas wells, to deduct from gross income an allowance for depletion. The relevant sections of the Act are copied in the margin.[1] The present litigation calls for decision as to the total allowance permitted and its apportionment between lessor and

[1]Revenue Act of 1926, 44 Stat. 9, 14, 42.

Title II.—Income Tax.

. . . . . .

Part III.—Corporations.

. . . . . .

Deductions Allowed Corporations.

Sec. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

. . . . . .

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; (U. S. C. App., Title 26, Sec. 986).

Title II.—Income Tax.

. . . . . .

Part I.—General Provisions.

. . . . . .

Basis for Determining Gain or Loss, Depletion, and Depreciation.

Sec. 204. (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the

lessee where the income is derived from operation under an oil and gas lease.

During 1925, 1926 and 1927 the respondent, as assignee of the lessee named in an oil and gas lease, extracted substantial quantities of oil. By the terms of the lease and the assignment it was obligated to pay royalties in cash or in kind, totalling one-quarter of the oil extracted. The respondent claimed that the gross proceeds of all the oil produced should form the basis for the computation of the allowance for depletion granted by Section 204(c) (2), but the petitioner ruled that the deduction should be limited to 27½ per cent. of gross production less royalties paid. The Board of Tax Appeals sustained the ruling.[2] The Circuit Court of Appeals reversed the Board.[3] The case is here on writ of certiorari.[4]

The petitioner construes Section 204 (c) (2) in *pari materia* with Section 234(a) (8), and asserts the percentage deduction permitted by the former is subject to the requirement of equitable apportionment between the lessor and lessee required by the latter. The respondent urges that Section 204(c) (2) is an independent and complete provision, to be applied without reference to Section 234(a) (8), and that to attempt to apportion the allowance granted by Section 204(c) (2) in the manner indicated by Section 234(a) (8) would violate the plain terms of the statute.

Reference to the structure of the successive income tax laws will aid in a solution of the problem. The Revenue Act of 1916[5] imposed an income tax by Title I. It divided the provisions as to tax into two parts, Part I on individuals, and Part II on corpora-

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same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

. . . . . .

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph. (U. S. C. App., Title 26, Sec. 935.)

[2] 26 B. T. A. 172.

[3] 70 F. (2d) 402.

[4] 293 U. S. —.

[5] 39 Stat. 756.

tions. In each part the statute first lays the tax and in a subsequent section grants certain deductions, those enumerated in Section 5 of Part I being available to individuals, and those specified in Section 12 of Part II to corporations. Both sections include a reasonable allowance for depletion in the case of oil and gas wells. In the drafting of the Revenue Act of 1918[6] a new arrangement of the subjectmatter was adopted. Title I is composed of definitions, Title II treats of income tax. Part I of this title consists of general provisions applicable alike to individual and corporate taxpayers. Sections under this part define taxable years and dividends, and Section 202 prescribes the "basis for determining gain or loss," but makes no reference to depletion of mines, timber, or oil and gas wells. Additional sections have to do with inventories, net losses, and other general matters. Part II levies the tax on individuals, defines net and gross income, and in Section 214 specifies the deductions allowed from gross income. The opening sentence of subsection (a) (10) is:

"In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted."

Then follow two provisos, one directing how cost shall be ascertained in the case of properties acquired prior to March 1, 1913, and the other allowing an alternative method of calculating depletion upon the basis of discovery value of mines and oil and gas wells. The paragraph ends with the sentence:

"In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

In Part III, levying the corporation tax, Section 234(a) (9) allows a deduction for depletion in the identical phraseology employed with respect to individual taxpayers in Section 214(a) (10). The same method was followed in the Revenue Act of 1921.[7] The general provisions contain no reference to depletion, but under Parts II and III of Title II the tax is fixed for individuals and corporations and the allowable deductions from gross income are set forth. The paragraphs of the prior Act as to depletion of oil

[6] 40 Stat. 1057.
[7] 42 Stat. 227.

and gas wells are literally reenacted, but there is inserted in Section 214(a) (10) as to individuals and Section 234(a) (9) as to corporations, an additional proviso with respect to discovery value.

In the framing of the Revenue Act of 1924[8] the same arrangement was observed. General definitions are found in Title I; Title II treats of income tax, and in Part I of that title are included general provisions applicable to both individual and corporate taxes. Amongst such general provisions in the earlier acts there had been a section entitled "Basis for determining gain or loss." In the 1924 Act the draftsman embodied paragraphs similar to those of the earlier act in Section 204, but enlarged the caption to read "Basis for determining gain or loss, *depletion, and depreciation,*" and transferred to this section that portion of the depletion provision dealing with the basis of the allowance which had formerly appeared under the heading "Deductions" in Part II, Individuals, and Part III, Corporations. This added to the old Section 204 a new subsection (c), which permits the use of cost or discovery value as the basis of depletion in the case of mines and oil and gas wells. Having transferred these provisions from Sections 214 (a) (9) and 234 (a) (8), respecting individual and corporate deductions, there remained in those sections the language first found in the Act of 1918, above quoted, including the concluding sentence relating to equitable apportionment between lessor and lessee. The thought apparently was that the authority for the deduction should remain in the sections dealing with all deductions and the formulae for calculating the deduction should be relegated to a general provision applicable alike to corporations and individuals.

The depletion allowance based on discovery value was found difficult of administration, since it required a separate valuation of each well,[9] and was abandoned in the Revenue Act of 1926.[10] There was substituted a flat allowance of 27½ per cent. of gross income. In this Act the same arrangement was followed as in that of 1924. Under Title II, Income Tax, Part I was devoted to general provisions. As the basis for determining gain or loss, depletion and depreciation, had been embodied in Section 204 of

[8] 43 Stat. 253.

[9] See Senate Report No. 52, 69th Cong., 1st Sess., p. 17.

[10] 44 Stat. 9.

the general provisions of the Act of 1924, in which was the permitted use of discovery value as a basis for depletion, when that method was discarded in favor of the flat percentage of gross income it was logical to insert the substituted paragraph in the place where the discarded one had been. Thus we find the new formula inserted as paragraph (c) (2) of Section 204. The authority for deduction of depletion remains where it has always been since the Act of 1918, namely, in Section 214 (a) (9) of Part II, Individuals, and Section 234 (a) (8) of Part III, Corporations, and naturally there still remains in these paragraphs the limitation that the allowance shall be apportioned between lessor and lessee.[11]

This outline of the framework of the legislation demonstrates that Congress did not insert Section 204 (c) (2) as an independent section *granting* an allowance or deduction for depletion. In the earlier Acts both the grant and the method of computation were embraced in a subsection under the title "Deductions." In the later Acts of 1924 and 1926 the grant remained in the deduction section and the taxpayer was referred to a general provision in Section 204 for the method of ascertaining its amount.

Respondent emphasizes the last clause of Section 204 (c) (2), which is: "except that in no case shall the depletion allowance be less than it would be if computed without reference to this

[11]In framing the Revenue Act of 1928 (45 Stat. 791) the draftsman reverted to an arrangement similar to that found in the Revenue Act of 1916. Thus under Title I an income tax is laid on both individuals and corporations, and in subsequent portions of the Act general provisions are contained. In this Act the deductions from gross income are found in Section 23 under Part II, "Computation of Net Income," and the language of Section 214 (a) (9) and Section 234 (a) (10) of the Revenue Act of 1926 is found only in this section, applicable to both sorts of taxpayers, corporate and individual, as subsection (l). A new subsection (m) is added, which states: "The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114." Section 114 is found in Supplement B, and so far as material here is the same with respect to gas and oil wells as the analogous portions of Section 204 (c) of the Act of 1926.

It is quite clear, therefore, from this cross-reference, that the framers of the Act understood the deduction was allowed by Section 23 (l) but the method of calculating it was to be ascertained by reference to a general provision on that subject, Section 114.

paragraph." It is argued that as this exception gives the taxpayer an option to compute the allowance either on the cost basis or by the flat percentage method, if he elects the former he proceeds under 234 (a) (8). Thus it is said that section applies only in case the cost basis is chosen. But an examination of the statute demonstrates the error of this position. No basis or formula for computation of the allowance is found in Section 234; on the contrary all permissible procedures are covered by Section 204, whether cost depletion of mines and oil wells (paragraph (c); discovery value basis in the case of mines (c) (1); or flat percentage of gross income in the case of oil and gas wells (c) (2). If, therefore, the taxpayer does not compute under (c) (2) he must do so in accordance with the cost method prescribed by the earlier paragraph (c) of the same section, and not, as contended, under 234 (a) (8).

It follows that whichever method outlined in Section 204 is chosen for computing the allowance granted by Section 234, the deduction must be apportioned between lessor and lessee.

We come, then, to consider the propriety of the procedure followed by the Commissioner. What he did, in effect, was to treat the gross production less royalties as the measure of the respondent's depletable interest in the property, and the royalties as the measure of the depletable interest of those entitled to receive them. The respondent says, however, that under Section 213 the gross production of the wells is respondent's gross income from the property, must be reported as such, and Section 204 (c) (2) permits him an allowance of 27½ per cent. thereof. It must follow that the royalties (one-fourth of the same gross production) are gross income to those receiving them and are subject to depletion at the rate of 27½ per cent. The result would be a total allowance of 27½ per cent. of five-fourths of the total production. Certainly this would not be a single allowance, apportioned between lessor and lessee. And we think Section 204 (c) (2) does not require such a result. The words used are, "the allowance for depletion shall be 27½ per centum of the *gross income from the property* during the taxable year." Is the italicized phrase synonymous with the taxpayer's gross income as defined in Section 213? It cannot be if "property" signifies the tract of land in all its uses, others as well as the extraction of oil and gas. *Darby-Lynde Co.* v. *Alexander* 51 F. (2d) 56. The phrase, we think, points only to the gross in-

come from oil and gas. Compare *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 461; *Greensboro Gas Co.* v. *Commissioner*, 30 B. T. A. 1361. So restricted it presents no difficulty where the owner of the land is also the operator, and there is none where the lessee turns over royalty oil in kind to the lessor, for the retained oil, in that case, is the base for the lessee's computation of depletion and the royalty oil that for the lessor's. We think Congress did not intend a different result where, as here, the lessee sells all the oil and pays over the royalty in the form of cash.

At all events, as the section must be read in the light of the requirement of apportionment of a single depletion allowance, we are unable to say that the Commissioner erred in holding that for the purpose of computation "gross income from the property" meant gross income from production less the amounts which the taxpayer was obliged to pay as royalties. The apportionment gives respondent 27½ per cent. of the gross income from production which it had the right to retain and the assignor and lessor respectively 27½ per cent. of the royalties they receive. Such an apportionment has regard to the economic interest of each of the parties entitled to participate in the depletion allowance. Compare *Palmer* v. *Bender*, 287 U. S. 551, 558.

The respondent insists that, so applied, the section may work unjust and unequal results; but it is to be remarked that this is likely to be so wherever a rule of thumb is applied without a detailed examination of the facts affecting each taxpayer. No doubt, as the petitioner points out, equally illogical results might ensue the application of the section as the respondent construes it. And it is also to be remembered that depletion upon cost or March 1, 1913 value is optional with the taxpayer, if that procedure is more favorable to him.

Finally the respondent says that in the Revenue Act of 1932[12] the section corresponding to 204 (c) (2) was amended so as to authorize such a procedure as the petitioner adopted in this case, and therefore the section as it stood in the Act of 1926 could not have supported the Commissioner's ruling. The amendment alters the section to read:[13] "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income

[12]47 Stat. 169.

[13]Section 114 (3), 47 Stat. 202.

from the property during the taxable year, *excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property* . . . ." The petitioner says that the amendment was merely clarifying in purpose and declaratory of the existing law as administered. We think this is so. When it was offered the chairman of the committee having the bill in charge so stated,[14] and the conference report is to the same effect.[15]

The judgment is reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

[14]Cong. Record, Vol. 75, Part 10, pp. 11629-11630.

[15]House Conference Report No. 1492, 72d Cong., 1st Sess., p. 14.